No. 8881

In the United States

Circuit Court of Appeals

For the Ninth Circuit

INVESTORS SYNDICATE, PORTLAND TRUST AND SAVINGS BANK, Trustee, and METROPOLITAN LIFE INSURANCE COMPANY,

Appellants,

vs.

LLOYD R. SMITH, Trustee in the Matter of Guaranty Trust Company, a corporation, and National Investment Company, a corporation, its affiliate, Bankrupts, GESINA KING, HELEN WINSOR JOHNSON, BERT WHY and ELSA STRATHMAN, MRS. GOW WHY, CONRAD BAURIEDEL, IDA ISABELL NEILSON, GEORGE J. and EMMA C. FOURIER, JAMES T. JONES and LOUIS KNUTSON, and RALPH A. COAN and S. J. BISCHOFF,

Appellees.

BRIEF OF APPELLANTS

Upon Appeal from the District Court of the United States for the District of Oregon.

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STEVENS-NESS LAW PUB. CO., PORTLAND 82889—40—1-39

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JURISDICTIONAL STATEMENT UNDER RULE 24 (b)

This case arises on the joint and several appeals of Portland Trust and Savings Bank, Metropolitan

Life Insurance Company and Investors Syndicate from "Order Sustaining Exceptions to Special Master's Report dated November 14, 1936, filed November 16, 1936, and directing Trustee to file a report and accounting". Such appeals were taken under Sections 24a and 24b of the Bankruptcy Act (R.* 141, 143, 147, 154, 158, 164). Involuntary petition in bankruptcy was filed against bankrupt in the court below January 29, 1934 (R. 5) and jurisdiction taken under Section 77B July 11, 1934 (R. 5), pursuant to petition filed by the alleged bankrupt by way of supplemental answer to the involuntary proceedings. Appellants by petitions filed in the District Court (R. 16, 28, 35) as mortgagees holding separate mortgages on various apartment houses, title to which was vested in the debtor, claimed rents and profits collected by the Trustee during the course of the 77B proceedings. Such petitions were referred to a Special Master (R. 63) whose report sustaining appellants' petitions was filed with the District Court (R. 71). Exceptions to the report were filed by Ralph A. Coan and S. J. Bischoff in their own behalf and as attorneys for the creditors who filed the involuntary petition in bankruptcy, and for the intervening creditors who appeared in support of such involuntary petition (R. 121). Order sustaining such exceptions was entered by the District Court (R. 137) being the order herein appealed from.

* For brevity the Transcript of Record will be referred to herein as "R".

STATEMENT OF THE CASE

This case comes up under agreed statement of the case under Equity Rule 77 (R. 5). The case involves the question as to the rights of mortgagees to rents and profits after bankruptcy has supervened before actual possession has been taken by the mortgagees, timely application for sequestration of the rents and profits having been made by each of the mortgagees. Each of the mortgagees, Portland Trust and Savings Bank, Metropolitan Life Insurance Company and Investors Syndicate, claims under separate mortgages. The order appealed from denied the relief prayed for by the mortgagees on the broad ground that under the Oregon law a mortgagee is not entitled to rents and profits unless actual possession be taken or unless a receiver be appointed prior to bankruptcy. All of the appellants contend herein that their prompt and repeated demands in the bankruptcy court for application of the rents and profits to the mortgage debts constituted the equivalent of possession or a receivership outside of bankruptcy and so entitled them to accruing rents. Portland Trust and Savings Bank contends further under special facts applicable to it that proceedings in foreclosure prior to bankruptcy were such as to amount to a sequestration of the rents and profits.

All of the mortgages here involved were in de-

fault prior to bankruptcy* (R. 8, 19-20, 30, 39, 60). This default extended not only to principal and interest, but taxes were delinquent and unpaid for several years preceding bankruptcy and the properties were in a state of waste and disrepair (R. 68, 69). The amount due on each of the mortgages was in excess of the value thereof at the time concerned (R. 69). All of the mortgages expressly mortgaged and assigned as a part of the security the rents, issues and profits, and contained provisions for assignment of rents (R. 26, 35, 49, 54-60), and for appointment of receiver in the event of foreclosure (R. 26, 35, 49, 54-60). Furthermore, Investors Syndicate held separate assignments of rentals on three of its mortgaged premises in addition to the mortgages thereon (R. 54). All of the mortgages were duly and promptly recorded (R. 27, 35, 60).

Certain special facts relate to Portland Trust & Savings Bank, and it will clarify matters at this stage to state those facts, and later describe how the questions on appeal arise as to the other defendants.

Portland Trust and Savings Bank (hereinafter sometimes called Bank) several months prior to bankruptcy, to-wit, on August 2, 1933, instituted separate foreclosure suits in the Circuit Court of Multnomah County, Oregon, on two mortgages held

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* The petitions of appellants (R. 19, 30, 39) alleged such defaults. The agreed statement herein shows that at the hearings such allegations were admitted to be true (R. 60, 65).

by it on apartment houses, legal title to which was in bankrupt (R. 8). These foreclosures were for the full amount of principal and interest and it appeared that no taxes had been paid since 1929 (R. 8). Plaintiff applied in each of these causes for the appointment of a receiver, but in lieu of the appointment of a receiver the court entered an order reciting that

> "the interest of all parties to said suit may be protected by requiring the defendant * * * to file in this court during the pendency of this suit, verified monthly accounts showing all money received and all disbursements made in the operation of said apartment houses and to pay the net income from said property into court to be disposed of according to the further order of the court and that the necessity of a receiver may be thereby dispensed with" (R. 9-10).

The court further ordered that Guaranty Trust Company serve and file monthly a verified account or report covering the operation of the apartment house involved in each suit

> "showing all rentals and other income received from said apartment house and all disbursements made on account thereof during said accounting period; and that said Guaranty Trust Company, at the time of filing said account and report, pay into the Court the net income derived from said mortgaged premises during said accounting period, *to be held as a part of the security for said mortgage indebtedness* and to be applied according to the further orders of the Court" (R. 10). (Italics ours.)

This order was dated August 10, 1933, and was thereafter modified by permitting a 20% deduction as compensation for use of furniture owned by the bankrupt.

Guaranty Trust Company filed in the state court monthly statements in compliance with said orders and paid to the Clerk of the Court the net rentals computed as aforesaid. None of these moneys ever came under the jurisdiction of the bankruptcy court, and are not involved in this appeal (R. 11).

The involuntary petition herein was filed January 29, 1934, being succeeded by 77B proceedings instituted by supplemental answer filed July 11, 1934 (R. 5). On January 31, 1934, the District Court ordered a stay of all proceedings against the alleged bankrupt (R. 11) but on April 25, 1934, on motion of Guaranty Trust Company, the District Court **modified that order by permitting the alleged bankrupt to comply with the order of the state court in the foreclosure proceedings above described requiring the alleged bankrupt to pay into the state court monthly the net rentals as before described.** The District Court order specifically permitted the parties to said foreclosure suits in the state court to proceed therewith (R. 11-12). Accordingly, the alleged bankrupt continued to pay the net rentals to the state court until the month of June, 1934 (R. 11).

Upon institution of 77B proceedings June 11,

1934,* the bankrupt continued to make monthly reports and delivered same to John W. Kaste, its counsel. Kaste, being uncertain to whom the funds belonged, retained possession thereof. The Trustee in Bankruptcy did not begin to collect the rentals until September 11, 1934, and thereupon proceeded, and continued to collect same (R. 12). The moneys previously accumulated in Kaste's hands were later paid to the Trustee and are now held by him (R. 13).

All moneys collected by the Trustee from the properties mortgaged to the Bank have at all times been and still are held in a separate bank account and the Trustee now holds certificates of deposit of the Bank of California in the amount of $7,709.00 representing such rentals (R. 13). Such fund was referred to by the opposing parties herein and counsel as a "trust fund" in testimony at the hearing herein (R. 14-15).

All of the appellants, Investors Syndicate, Portland Trust and Savings Bank, and Metropolitan Life Insurance Company, took timely and appropriate action to protect and preserve their rights to the rents and profits derived from their respective properties.

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* Debtor filed petition in 77b on June 11, 1934, but same was on motion stricken because it should have been presented by supplemental answer, which debtor accordingly filed July 11, 1934, when good faith order was entered ex parte (R. 39).

Jurisdiction was taken herein under 77B by an ex-parte order without notice to creditors (R. 6). The first opportunity accorded the appellants and other creditors to participate in the proceeding was on August 2, 1934, when a hearing was held before the Special Master. At that time appellants appeared by their counsel along with other creditors, including the petitioning and intervening creditors who now appear as appellees, and opposed the continuance of the bankrupt in possession (R. 6). At an adjourned hearing before the Special Master appellants asserted their rights as mortgagees, filed written objections to the plan of reorganization proposed by the debtor, and renewed their oral objections to the continuance of the bankrupt in possession of the mortgaged premises (R. 6). Based upon said hearing the Special Master recommended the appointment of a trustee to take possession of the debtor's assets and further recommended "that a separate account should be kept by the trustee of all moneys coming into his hands from the several sources so that the disposition of said funds can ultimately be made in accordance with the determination that the court may hereafter make as to the ownership thereof, *and in particular that separate account be kept of the moneys received from the operation of each of the properties covered by said mortgage*" (R. 7). (Italics ours.)

The Master also recommended that "an order be made and entered herein appointing a trustee of the property, assets and business of the alleged

bankrupt, with instructions that all income, revenue, and receipts that shall come into his hands shall be segregated and handled as above suggested" (R. 7). This report was confirmed by the court by order dated August 13, 1934, in which it was further:

> "Ordered that the said trustee will keep separate accounts of all moneys coming into his possession from each of the several properties of the debtor or its said affiliate and that the trustee's accounts shall be kept so that all income and revenues received and expenses incurred in the operation of each of such properties can at all times be ascertained and segregated" (R. 7-8).

Pursuant to the recommendations of the Special Master and the order of court confirming the same, C. W. Twining was appointed trustee on September 10, 1934, and took possession of the debtor's property and assets (R. 8). At all times since, the trustee has complied with the order of court requiring segregation in his accounts of the rents, issues and profits received by him and expenditures made as to each of the mortgaged properties and from time to time has filed such accounts in the bankruptcy court (R. 71).

The appellant, Investors Syndicate, on October 22, 1934, filed in the District Court in this proceeding a petition in which it set forth that it held mortgages on five apartment houses owned by the debtor of which possession had been taken by the trustee in said proceeding, that said mortgages were all in

default, that principal installments were unpaid and interest was greatly in arrears, that taxes were delinquent since 1929, that the properties were in a bad state of repair and that the security was inadequate, and prayed for an order granting petitioner leave to foreclose its mortgages and requiring the trustee in bankruptcy to collect and segregate in the name of Investors Syndicate for application upon its mortgage indebtedness all of the rents and profits which had accrued or would thereafter accrue from the properties upon which Investors Syndicate held mortgages (R. 36).

Appellant Metropolitan Life Insurance Company on October 24, 1934, filed a petition setting forth substantially the same facts with reference to the existence and condition of its mortgage and asked for the same relief as that prayed for by Investors Syndicate.

Portland Trust and Savings Bank served and filed its formal petition for rents and profits under date of February 5, 1935 (R. 16). Such petition contended that the rentals were subject to application for the mortgagee's benefit prior to the bankruptcy proceedings and that such application should be continued by deposit in the state court or otherwise (R. 25). Reference was made in this petition to the fact that throughout the bankruptcy proceedings and continuing until June, 1934, the bankruptcy court had permitted the rentals to be paid by the bankrupt into the state court (R. 23). Refer-

ence was further made to the fact that subsequent thereto, said rentals were paid to Kaste and held by him until such time as the Trustee herein took over the collection of the rentals (R. 23, 24). At the time of the petition Kaste was still holding the rentals collected by him during this intervening period (R. 24).

It was stipulated at the hearing before the Special Master that the facts in all of the petitions of the appellants herein were true with the exception of certain allegations as to the value of the mortgaged properties of Investors Syndicate (R. 60) upon which undisputed evidence was received which showed that the value thereof was less than the mortgage indebtedness (R. 69). Among the allegations so admitted by appellees (R. 60-61) was paragraph VIII of the Bank's petition which reads as follows (R. 24-25):

> "That the said John W. Kaste is connected with said foreclosure suits and with this bankruptcy proceeding only in the capacity of attorney at law representing Guaranty Trust Company and National Investment Corporation; that the said John W. Kaste has no right to, interest in, or claim upon said funds, and that the same should be paid into the Circuit Court of the State of Oregon for Multnomah County, pursuant to the terms of said orders of Court. That likewise, the net rentals derived from said mortgaged premises which are now in the possession of said C. W. Twining, as Trustee in Bankruptcy, constitute a part of the security for the mortgages described herein and were duly impounded by orders of Court entered in

> said foreclosure suits long prior to the time when this bankruptcy proceeding was instituted, and said funds should be paid into said Circuit Court."

On April 23, 1935, the Special Master filed a report wherein he recommended that the mortgagees be permitted to proceed with foreclosure and that the net proceeds from each mortgaged property be segregated and paid to the holder of each mortgage respectively. No order was made relative to this report (R. 61). On May 21, 1935, Metropolitan again filed petition for leave to foreclose (R. 61-62). On June 3, 1935, Investors Syndicate filed a similar petition and on June 5, 1935, Portland Trust and Savings Bank filed motion for order permitting it to proceed with its state court foreclosures (R. 62).

Accordingly, orders were entered permitting said foreclosures to proceed (R. 62).

On October 9, 1935, an order was entered that reorganization could not be effected, that the bankrupt was insolvent and that it should be liquidated (R. 62). A trustee was appointed for that purpose and the order provided, as had the previous orders, that the trustee was to keep separate accounts of all moneys coming into his possession from each of the mortgaged properties (R. 63). Thereupon the court ordered a reference as to ownership of rents and a hearing was held before Roy F. Shields, Special Master, who in a full and well considered re-

port held in favor of the mortgage creditors.* The uncontradicted evidence before the Special Master was that taxes were delinquent since 1929; that for a considerable period prior to bankruptcy the income from the properties had not been used to pay taxes, interest or other charges; that the debtor ran itself before bankruptcy by using such income, which was practically all the income that the bankrupt had; that during the administration of the Trustee in Bankruptcy herein the bankrupt was in a state of total collapse; that fire insurance was not maintained on the mortgaged properties nor repairs made except those absolutely necessary to make the rooms habitable; and that the condition of the bankrupt became worse as the bankruptcy proceedings continued (R. 68-69). It is further admitted herein that bankrupt was insolvent at the time bankruptcy proceedings commenced; that the involuntary petition was resisted in the hope that 77B would be enacted and that counsel for bankrupt "stalled" the proceedings until the effective date of such Section 77B (R. 68). A reorganization plan was filed as part of the supplemental answer of the debtor wherein it was proposed that the mortgagees scale down their principal 25% and also reduce their interest rate, which proposal was at all times unacceptable to the mortgagees (R. 68). It therefore became at once evident to counsel for bankrupt that the proceedings were hopeless (R.

* The Special Master's Report is quoted in full in the Record (R. 72-121).

68), but the debtor employed additional counsel in the hope that it could convince the mortgagees to cut down their balances. It was finally determined that reorganization was hopeless (R. 68).

The Trustee has complied with the order of court requiring segregation in his accounts of the rents, issues and profits received by him and expenditures made as to each of the mortgaged properties and from time to time has filed such accounts in the bankruptcy court (R. 71).

It is to be noted that the hearing before the Special Master occurred November 20, 1935 (R. 13), but his report was not filed until November, 1936 (R. 71). Exceptions to the report were filed December 5, 1936, and the order sustaining the exceptions was filed June 8, 1938. Owing, therefore, to the great lapse of time between the date of the original hearing and the present date, it is not possible in the present state of the record to present to the court the full facts and details which have transpired since that date with relation to the foreclosures and the amounts collected. Therefore, if the court find on this appeal that appellants are correct in their legal contentions, an accounting will be necessary as to the rents and the mortgagees will, of course, be limited to the amount of the deficiencies on their respective mortgages (R. 70).

The lapse of time since the hearing before the Special Master renders presentation of the case somewhat awkward in that certain facts in which

the court is interested are not in the record because they occurred subsequent to the report. The fact is, and it will simplify matters if appellees so concede in their answering brief, that all of the mortgages here involved were ultimately foreclosed by separate proceedings and deficiencies obtained, and that the money claimed herein by each of the mortgagees is accordingly the amount of such deficiencies with interest.* Likewise, after the hearing before the Special Master, although not appearing in the record herein, the moneys in the hands of the Clerk of the Circuit Court of Multnomah County, Oregon, in the foreclosure suits of Portland Trust and Savings Bank were applied upon the decrees, pursuant to the original order which recited that same were to be deposited with the Clerk of the Court "to be held as a part of the security for said mortgage indebtedness and to be applied according to the further orders of the Court" (R. 10). We assume that counsel will admit these matters, but if not, since further proceedings in the trial court will be had in the event of reversal in order to bring the facts down to date, such later events may then be taken fully into account.

The District Court reserved decision on the question whether failure of the Trustee to pay taxes accruing during the period he collected the rents (R. 66-9) entitles the mortgagees to reimbursement

* Judge Fee's opinion refers to the fact that "the foreclosures proceeded to sale" and that the creditors have deficiency judgments (R. 129).

for taxes paid by the mortgagees for such period (R. 141). This question was considered by the Special Master (R. 114-16). But in deference to the ruling of the trial court that question will not be considered herein. In accordance with the trial court's ruling, all rights based on that issue are reserved for the further consideration of the trial court, if that be necessary.

SPECIFICATION OF ERRORS RELIED UPON

Appellants herein rely upon assigned errors 1, 2, 3, 4, 5 and 6 (R. 144-6, 159-161). The errors assigned are identical in substance and assigned number, as to the appeals both under Section 24a and 24b herein.

ASSIGNMENTS OF ERROR 1 to 6, INCLUSIVE*

The Court erred in holding that rentals collected by the Trustee from the various apartments mortgaged to appellants herein should be held as part of the general estate, available for the payment of expenses of administration and claims of the estate.

* The assignments of error appear verbatim in Appendix, p. A-1. We believe it will lighten the burden of the Court and simplify the argument to consider all the assignments of error together, inasmuch as similar questions of law are presented by all of such assignments. Additional points of law are presented as to assignments of error 3 and 4 relating only to Portland Trust & Savings Bank, but the consideration of the assignments of error relating to the bank require discussion also of matters of law pertaining to the other assignments of error.

The Court erred in sustaining the exceptions of the petitioning and intervening creditors and Messrs. Coan and Bischoff to the Special Master's conclusions of law numbered 1 to 8, inclusive, which held that the respective mortgagees were entitled to such rents and profits after appropriate deduction therefrom for reasonable furniture rental and property management charge.

ARGUMENT*

PRINCIPLES APPLICABLE TO ALL APPELLANTS HEREIN — DEMAND FOR RENTS, OR ORDER OF SEGREGATION, IN BANKRUPTCY COURT SUFFICIENT.

We propose to show that demand by a mortgagee in the bankruptcy court for rents and profits, or an order of segregation by the bankruptcy court, even without such demand, is sufficient to entitle the mortgagee to rents thereafter collected.

All the authorities agree that the bankruptcy court, even in 77b proceedings, takes the bankrupt's assets subject to prior liens, and therefore that where a mortgagee has sequestered the rents and profits, either by actual possession, possession through a receiver, or otherwise, the mortgagee's rights are prior:

* Limitations of space prevent inclusion of "Summary of Argument". However, for the convenience of the court such "Summary of Argument" has been prepared and is included in Appendix, p. B-5.

Duparquet v. Evans, 297 U.S. 216, 222; 80 L. Ed. 591.
Straton v. New, 283 U.S. 318; 75 L. Ed. 1060.
Continental Bank v. 19th & Walnut Corp., 79 F. (2d) 284 (C.C.A. 3rd).
Re Shelburne, 91 F. (2d) 190 (C.C.A. 3d).
Federal Reserve v. Weant, 113 Or. 1.
Petition of Cox, 15 F. (2d) 764.

Thus, in *Duparquet v. Evans*, 297 U.S. 216, 222, 80 L. Ed. 591, the court stated:

> "* * *, it is * * common learning that not even a trustee in bankruptcy may override a valid mortgage lien or supersede a receiver who has been put into possession in fulfilment of the mortgage contract. Straton v. New, 283 U.S. 318, 322, 327, 75 L. Ed. 1060, 1093, 1098, 51 S. Ct. 465; Metcalf v. Barker, 187 U.S. 165, 47 L. Ed. 122, 23 S. Ct. 67; Lincoln Sav. Bank v. Realty Associates Security Corp. (C.C.A. 2d), 67 F. (2d) 895; Re Berdick (D.C.), 56 F. (2d) 288; Russell v. Edmondson (C.C.A. 5th), 50 F. (2d) 175; Re Brose (C.C.A. 2d), 254 F. 664; Carling v. Seymour Lumber Co. (C.C.A. 5th), 113 F. 483, 491."

That sequestration prior to bankruptcy would bar the Trustee herein was expressly recognized in the opinion of the court below, citing the case of *American Trust Co. v. England,* 84 F. (2d) 352 (C. C.A. 9). (R. 127-8.)

The contention with which we are met in the present case is that since no receiver was appointed as such by the state court, the mortgagees have forever lost their rights to the rents and profits until such time as they obtain title to the property through

foreclosure. In other words, the contention is that the bankruptcy court alone has jurisdiction where there is no prior receivership, and since there is no method of applying to the bankruptcy court for a receiver of mortgaged property, the mortgagee is without remedy. Such in effect is the holding of the court below (R. 128-9).

This argument, we believe, confuses form with substance. It implies that the bankruptcy court, having sole jurisdiction, holds adversely to all secured creditors and that the latter are utterly without remedy pending such time as foreclosure is permitted and completed.

It is true that the trustee in bankruptcy is entitled to possession of all assets theretofore in possession of the bankrupt: *Isaacs v. Hobbs*, 282 U.S. 734. However, the very fact that the trustee has paramount title and possession, exclusive of all other courts, imposes upon the bankruptcy court the duty to deal fairly with those assets as to all creditors, both secured and unsecured. This has been recognized repeatedly by the courts.

MORTGAGEE IS ENTITLED TO RENTS AND PROFITS UPON TAKING APPROPRIATE ACTION IN THE BANKRUPTCY COURT.

It is well settled in this Circuit that a mortgagee is entitled to the rents and profits from the date of application therefor to the bankruptcy court: *American Trust Co. v. England*, 84 F. (2d) 352 (C.

C.A. 9); *Re Hotel St. James Co.*, 65 F. (2d) 82 (C. C.A. 9).

We respectfully submit that there is an entire misconception in the opinion of the court below as to the holdings of these two cases. The court below cited the *St. James* case for the proposition that the weight of authority favors the award of rents and profits to the trustee (R. 124); and cited the *England* case for the proposition that the mortgagee is entitled to the rents and profits if he comes peaceably into possession.

The fact is that both the *St. James* case and the *England* case stand for the proposition that a mortgagee, who has *not* come into possession, nevertheless is entitled to the rents and profits from and after the date of application therefor to the bankruptcy court. In fact, as we will demonstrate, all of the decisions permit recovery by the mortgagee under such circumstances, the only dispute in the authorities being that some authorities go to the length of stating that the mortgagee is entitled to the rents and profits from and after the date of adjudication *without* any application to the court. All these authorities will be herein discussed.

In the *St. James* case the rents and profits were awarded to the trustee in bankruptcy solely for the reason that no application for the rents and profits had been made by the mortgagee until after all the rents had been collected and the property had been

sold on foreclosure, there being no prior sequestration of any kind. As stated by the court (p. 84):

> "No petition was addressed to the bankruptcy court to direct the general receiver, or the trustee, to sequester the rents and profits, as in Mortgage Loan Co. v. Livingston, supra; *no claim to the rents was made until after the sale.*" (Italics ours.)

The court in the *St. James* case disapproved the case of *In re Wakey,* 50 F. (2d) 869 (C.C.A. 7), which held that the mortgagee was entitled to the rents and profits from the date of bankruptcy without the filing of any petition. The reason for such disapproval, however, was that no application for the rents had been made in that case, just as no application was made in the *St. James* case, until after the rents had been collected. It is clear from the language of this court that had such an application been made the mortgagee would have been awarded the rents and profits. Thus, concerning the case of *Mortgage Loan Co. v. Livingston,* 45 F. (2d) 28 (C.C.A. 8), this court in the *St. James* case stated:

> "Moreover, immediately upon the appointment of the receiver in bankruptcy, the mortgagee requested sequestration of the rents, to which the receiver assented, and repeatedly thereafter asked leave to continue the enjoined foreclosure."

In *American Trust Co. v. England, supra,* decided by this court, the trustee in bankruptcy *of a third mortgagee* took possession of the mortgaged

property on September 17, 1932, with implied consent, so the court held, of the mortgagor, and proceeded to operate the ranch and collect the rents and profits. On October 13, 1932, the first mortgagee filed a petition in the bankruptcy case for the sale of the property and for an order sequestering the proceeds of the operation thereof. This was denied without prejudice. Thereafter, on January 26, 1933, the referee ordered that the trustee pay the net proceeds to the first mortgagee, or hold in a separate account subject to further order of the court. The trustee adopted the latter course. On July 26, 1933, on supplemental petition of the first mortgagee the trustee was ordered to surrender possession for the purpose of sale, which was done August 12th. The mortgagor was not a party to the proceedings. On July 28, 1933, the mortgagor demanded the sequestered funds from the trustee. On September 14, 1933, the first mortgagee filed a petition therefor and all parties submitted to the jurisdiction of the court. On these facts it was held that the first mortgagee was entitled to the proceeds from October 13, 1932 to August 12, 1933, when possession was surrendered by the bankruptcy court.

This is not a case, as stated in the opinion below (R. 127), where the mortgagee in question came peaceably into possession. The *third* mortgagee came into possession with the consent of the mortgagor, but not the *first* mortgagee. The mort-

gagor claimed adversely to the first mortgagee at all stages. So far as the first mortgagee was concerned, there was no difference in legal contemplation whether the prior possession of the third mortgagee was for the latter's account or for the mortgagor's account. In either case this possession was adverse to the first mortgagee. The case therefore was just the same as if the bankruptcy estate was that of the mortgagor instead of the third mortgagee, the rights of each of which were subject to the prior lien of the first mortgage. From the standpoint of the first mortgagee, adverse possession was vested in the bankruptcy estate, and since the bankruptcy estate had complete jurisdiction of the subject matter, there was nothing that the first mortgagee could do except to submit himself to the jurisdiction of the bankruptcy court by applying for the rents and profits. This he did and he was held entitled from the date of such application. The court stated (p. 356):

> "The demand of the appellant upon the trustee for the sequestration of rents, and the referee's order for the sequestration, is the equivalent of the taking of possession by the appellant under its trust instrument. Mortgage Loan Co. v. Livingston (C.C.A. 8), 45 F. (2d) 28."

The court in the *England* case then enters into a detailed discussion of *Mortgage Loan Co. v. Livingston*, as follows:

"In that case the mortgagees were entitled to possession under the provisions of the mortgage, but the possession was in the hands of a receiver in bankruptcy proceedings. The mortgagees requested the receiver to sequester the income from the mortgaged property from other income of the receivership. The receiver stated that he would so sequester this income. Afterwards, as here, the mortgagees filed a petition for leave to foreclose the mortgage. This was at first denied without prejudice. Thereafter, as in the present case, it was granted. In holding that the mortgagees were entitled to this income remaining in the hands of the receiver, the court said:

" 'In effect the mortgagees made themselves parties to the bankruptcy proceedings, recognized the receivership, but never acquiesced in an appropriation by him of the rents and issues of the property to the use and benefit of the general creditors, but promptly and persistently insisted that these rents and issues be impounded by the receiver, and either be used in the discharge of the taxes and insurance or be turned over to them. While it is true these mortgagees acquiesced in the collection of these rents and profits by the receiver, they did so on the understanding that they were impounded and would be properly applied or accounted for, and it cannot be said that they ever acquiesced in an appropriation of them by the receiver on behalf of the general creditors. They were, of course, unable to take possession of the property from the receiver, except on an order of court, and the record in this case warrants the conclusion that the receiver was acting not only on behalf of the general creditors, in so far as this property was concerned, but was acting also in behalf of these mortgagees, and he collected and impounded

these pledged rents and issues, keeping them separate from his other accounts for apparently no other purpose than to make them available as a part of the security under this second mortgage. * * * We are of the view that the mortgagees in effect intervened in the receivership proceedings in aid of their proceedings to foreclose, and this intervention operated to charge all of the net income arising from the operation of the property by the receiver with the lien of their mortgage. * * *

"'To hold that the mortgagees had a legal right to these rents and issues under the provisions of their mortgage, but that they should be precluded from recovering same because they had not technically pursued a legal remedy is to overlook the fact that the property was in the control of a court of equity, and that equitable remedies commensurate with the legal rights of the parties should be available. To take from the mortgagees the property to which confessedly they are entitled under the pledge provision of their mortgage, and transfer it to the unsecured creditors of the bankrupt, appeals to us as harsh, inequitable, and unwarranted.' Mortgage Loan Co. v. Livingston, supra (C.C.A.), 45 F. (2d) 28, 32, 33, 34."

The court in the *England* case distinguished the *Hotel St. James* case on the ground that in the latter case no petition was addressed to the bankruptcy court for the sequestration of the rents and profits.

In view of the very complete consideration of the case of *Mortgage Loan Co. v. Livingston* in the opinion of the court in the *England* case, we will not repeat the matters therein quoted. The *Livingston* case is one of the leading cases on this subject.

In the *Livingston* case no possession was taken by or in behalf of the mortgagee prior to bankruptcy, which occurred two days before the foreclosure sale set for June 29, 1927. The receiver in bankruptcy collected the rents until January 16, 1928. Shortly after the receiver took possession the mortgagee addressed a letter to the receiver asking that the accounts be separated and the revenues applied to the mortgage debt. The receiver answered that the revenues would be kept separately. Petition for application of the rentals was not filed until October 24, 1927, but it was held that the mortgagee was entitled to all the rents collected by the receiver, which included rents collected prior to the formal application to the bankruptcy court. This case illustrates that the bankruptcy requirement is that the mortgagee take *some affirmative action* showing his election to claim the rents and profits. The usual method is by application to the bankruptcy court, but in the *Livingston* case the sequestration dated back to the time of the letter to the receiver and the latter's prompt response that the funds collected from the mortgaged property would be kept separately. This situation is to be compared with the present case, where the court on institution of 77b proceedings required the trustee to keep separate all moneys collected from each of the mortgaged properties, and where the Portland Trust & Savings moneys were actually earmarked and set apart in a separate trust bank account.

We have thus far considered cases in the Ninth and Eighth Circuits. We turn now to consideration of cases in other Circuits:

The leading case in the Third Circuit is *Bindseil v. Liberty Trust Co.*, 248 F. 112. In that case it was held that rents collected by the trustee belonged to the mortgagee who filed a petition therefor. The only limitation upon this rule, as stated in the closing words of the opinion, was that the "claim thereto be seasonably asserted". The reasoning of the court in this case is worthy of notice. Judge Woolley, after stating the various remedies available to a mortgagee in different states within the Third Circuit prior to bankruptcy, goes on as follows (p. 114):

> "But bankruptcy changes the whole situation, takes from the mortgagor his land and its income, and takes from the mortgagee the legal remedies which, but for bankruptcy, he might pursue in reaching rents arising from the mortgaged premises, and gives him in lieu thereof, only such remedies as may be found in a court of bankruptcy in the equitable administration of the bankrupt's assets.
>
> "When rents from mortgaged premises become bankrupt assets and can no longer be reached by legal process, what constitutes an equitable administration of a law that takes away such process? When bankruptcy cuts off a creditor's legal remedies, under the exigencies of the debtor's insolvency, it does not destroy his legal rights in the debt or in its security. Under the scheme of bankruptcy these are preserved to him; but they are enforced in

a new way, made necessary by the bankrupt's financial collapse. In enforcing creditors' rights in the new way, it appears to us that equity should protect them in the same measure and preserve to them the same advantages, so far as practicable, that the law gave them before bankruptcy stepped in and interfered with them, having regard to their nature, their superiority, their priority. * * * That after insolvency has taken the debtor's property out of his hands, its income or product belongs to the lien creditor, who has thus become its virtual owner; and that such income or product issuing from mortgaged property, should not be diverted from the mortgage creditor who has a lien to general creditors who have no lien.

"This view is not based upon the notion that the mortgage confers a lien on rents, for, of course, it does not; but it is based upon what is conceived to be an equitable adjustment of rights, of which some are obviously superior to others. Such an application of income from encumbered property appears to be not only an equitable but a very practical way of administering bankrupt assets."

The case of *Central Hanover Bank v. Philadelphia R. R. Co.*, 99 F. (2d) 642, decided October 14, 1938, by the Third Circuit, holds pusuant to the same principles that under the extended jurisdiction of the court under 77b it is not even necessary for the mortgagee to file a petition, but he will be entitled to the rents from the date of bankruptcy.

The Fifth Circuit adheres to the same rule. In *Florida Bank v. U. S.*, 87 F. (2d) 896 (C.C.A. 5), 77b proceedings were filed while the mortgagee was

in possession of the mortgaged property. Stay order against pending foreclosure sale was granted by the bankruptcy court against the opposition of the mortgagee, who also petitioned that the rents be sequestered. Thereafter the proceedings were dismissed (in our case a liquidation has been ordered). It was held that the trustee must pay to the mortgagee the rentals in his hands less income taxes.

Re Thomas, also entitled *Dallas Trust v. Ledbetter,* 36 F. (2d) 221 (C.C.A. 5), is cited below as holding that the trustee is entitled to the rents (R. 124). That case, however, in no way departs from the general rule above set forth. In the *Dallas Trust* case the mortgagee did not apply to the bankruptcy court until after the rents had accrued. The contention of the mortgagee was that his rights were automatic and that by posting the notice of sale before bankruptcy he was entitled to the rents without more. As previously stated, the rule in most jurisdictions is that some affirmative action must be taken by the mortgagee to evidence his election. In view of the later case of *Florida Bank v. U. S., supra,* there can be no doubt as to the fact that the rule in the Fifth Circuit is that a mortgagee is entitled upon application (or even without application under 77b).

The court below cited as contra the case of *In re Brose,* 254 F. 664 (C.C.A. 2), but that case is entirely consistent with our view and does not depart from the general rule. There a voluntary petition

was filed April 30th. A receiver in bankruptcy was appointed May 2nd, who collected the rents from the mortgaged apartment house. The mortgagee on November 27th sued in the state court and obtained the appointment of a receiver Dec. 1st, which was evidently entered in the bankruptcy court under date of December 10th (see Opinion, p. 668). It was held under the New York rule laid down in the case of *Sullivan v. Rosson,* 223 N.Y. 217, 119 N.E. 405, that the mortgagee acquires no automatic rights to rents upon default but must take affirmative action to claim same. Here the mortgagee asserted no rights in the bankruptcy court until December 10, 1917, when he entered the order of the state court foreclosure receivership. *The significant fact of the case is that the court permitted the mortgagee to recover all rents and profits collected after December* 10. Therefore the *Brose* case is square authority for the proposition that when the mortgagee makes claim to the rents and profits in the bankruptcy court by appropriate petition thereto, he becomes entitled. The United States Supreme Court in the case of *Duparquet v. Evans, supra,* cited the *Brose* case in support of the proposition that a trustee in bankruptcy may not override a valid mortgage lien or supersede a receiver who has been put in possession. Of course, the state court receiver in the *Brose* case was not entitled to possession until such time as the bankruptcy court relinquished jurisdiction.

The Second Circuit also decided the case of *Re*

McCrory Stores, 73 F. (2d) 270. That case did not involve a mortgage, but assignment of future sub-rents as security under a lease. It was held that the lessor was not entitled to sub-rents which accrued during the month in which bankruptcy occurred because, first, the lease provided for assignment of sub-rentals accruing only after default, and there was no default, and second, "the lessor did nothing to assert a claim to them until after the rights of the trustee had attached". Had the lessor asserted his claim before the trustee collected the rents, a different story would have been presented.

It is to be remembered that in 77b proceedings, with which we are here concerned, the bankruptcy court is vested with all the powers which it would have possessed in a general receivership of the debtor's assets: Section 77b (a)*; *Duparquet v. Evans, supra.* The receivership rule as recognized and applied by the leading case in Second Circuit is that the receiver holds for secured creditors as well as unsecured and that a mortgagee is entitled to rents and profits upon filing petition therefor in the receivership case: *Prudential Ins. Co. v. Liberdar,* 74 F. (2d) 50 (C.C.A. 2). In that case the receiver filed a petition for the rents on December 15th, and it was held that the mortgagee was entitled from and after that date to all rents collected by the receiver after deduction for taxes. The reasoning of the court was that the mortgagee should not interfere with the possession of the court and

* Quoted, Appendix, p. C-10.

that the receiver should collect the rents and profits for the benefit of whomsoever should be entitled thereto, subject always to the right of the mortgagee to sequestration by appropriate petition. The court said:

> "The mortgagee must take steps to perfect his rights, and it ought to be assumed, as it was in Freedman's Savings & Trust Co. v. Shepherd, that the provision is not self-executing and that until he asserts his claim he is content to let the mortgagor receive the earnings of the premises."

We refer also to the opinion of the court as contained in the report of the Special Master (R. 112-113). It is noteworthy that the court in the *Liberdar* case considered that the applicable statute was analogous to the Oregon statute and that although the mortgagee had no possessory rights, he did have right to the rents upon application therefor. It was expressly held that the possession of the receiver was for the purpose of protecting the rights of all concerned and that the mortgagee "will have its rights protected as fully as though the properties were in its own possession and under its management".

Another recent Second Circuit case is *Lincoln Bank v. Realty Associates,* 67 F. (2d) 895 (C.C.A. 2), where it was held that the mortgagee was entitled to the rents and profits from and after the date of application. This case was approved in the *Duparquet* case, *supra.*

In re Humeston, 83 F. (2d) 187 (C.C.A. 2), is not to the contrary. There no application was filed until after the rents had been collected, and the opinion of the court clearly shows that had an application been timely filed, the mortgagee would have been entitled to the rents.

The First Circuit likewise awards the rents to the mortgagee from and after the date of application therefor: *Petition of Cox*, 15 F. (2d) 764. There it was contended, as in the opinion below (R. 132-4), that the filing of the involuntary petition in bankruptcy destroyed the mortgagee's right of entry to obtain the rents. The court, however, held that under Section 67d* of the Bankruptcy Act, a mortgagee's lien rights cannot be affected and that the opposite result would be "in the teeth of Section 67d: it would amount to transferring a part of his property to or for the benefit of unsecured creditors".

The Seventh Circuit holds that the trustee is entitled to the rents and profits even without application therefor: *Re Wakey*, 50 F. (2d) 869 (C.C.A. 7). That case was disapproved by the Ninth Circuit in the *Hotel St. James* case, supra, and it was there pointed out that the case conflicted with the previous decision of the Seventh Circuit in the case of *Re Clark Realty Co.*, 234 F. 576 (C.C.A. 7). Inferentially, therefore, this court approved the *Clark* case, which held that the mortgagee was entitled to the rents and profits from the date of application

* Section 67d is quoted, Appendix, p. D-11.

therefor to the bankruptcy court.

The court below, as argued by appellees, held that there was a split of authorities on the question whether a mortgagee may obtain the rents and profits from the bankruptcy court, citing Note, 75 A.L.R. 1526 (R. 124). We believe the foregoing discussion amply shows that all of the circuits agree that a mortgagee is entitled to the rents and profits, the only dispute being as to whether he must make any application therefor. This is expressly recognized in 75 A.L.R., which states the following:

> "By the weight of authority it is held that the mortgagor is entitled to rents and profits accruing up to the time the mortgagee enters, or brings a bill to foreclose or enter, and that this right inheres in the mortgagor's trustee in bankruptcy, and that the latter, *up to the time the mortgagee takes action,* takes the rents and profits for the benefit of the bankrupt's creditors." (Italics ours.)

The ordinary "action" by the mortgagee is by application or petition to the bankruptcy court, which is equivalent to an intervention: *American Trust Co. v. England, supra; Bindseil v. Liberty Trust, supra; Re Tamble, supra; Prudential v. Liberdar, supra.* But a formal application is unnecessary, if the circumstances otherwise show a sequestration: *Mortgage Loan v. Livingston, supra; Petition of Cox, supra; Re Industrial Cold Storage Co.,* 163 F. 390 (D.C., E.D. Pa.).

MORTGAGEE'S RIGHTS UNDER 77B

We have heretofore considered generally the rule of law that a mortgagee is entitled to the rents and profits in the bankruptcy court upon taking appropriate action after bankruptcy. The general rule has been considered from the standpoint of ordinary bankruptcy cases, although to illustrate the rule in various circuits reference was made to some of the cases under Section 77b and Section 74. We propose now to direct the Court's attention to the proposition that there is even more reason under Section 77b to protect the mortgagee than in the ordinary bankruptcy case (see Special Master's report, R. 110-114).

The rule is established in an ordinary general equity receivership that a mortgagee is entitled to the rents and profits by application therefor to the equity court: *Prudential Insurance Co. v. Liberdar*, 74 F. (2d) 50 (C.C.A. 2). The 77b statute itself by its express terms carries over to 77b all the powers of a federal court in a general equity receivership: Section 77b (a).*

The purpose and scope of 77b proceedings are clearly and fully described by Mr. Justice Cardozo in *Duparquet v. Evans*, 297 U.S. 216, 222, 80 L. Ed. 591, wherein the learned justice stated that one of the primary purposes of 77b was to extend the field

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* This subdivision of the statute is quoted in Appendix, p. C-10.

formerly occupied by a general equity receivership. Owing to the limitations of an equity receivership, it became necessary by federal legislation to offer ways and means to effect reorganizations despite dissenting security holders, who formerly often established a nuisance value. The method devised by 77b is to hold the debtor's assets substantially intact pending such time as is required to determine whether a reorganization can be effected. Therefore, the power of the bankruptcy court extends to the stay of pending proceedings, such as the state foreclosure suits instituted by Portland Trust & Savings Bank: Sec. 77b (c) 10.* By the express terms of Section 77b (a) the court is vested with and may exercise all the powers which a federal court would have had had it appointed a receiver in equity of the debtor's property by reason of the latter's inability to pay its debts as they mature. In the *Duparquet* case the court carefully defined general equity receivership as compared with a liquidating receivership for purposes of a mortgage foreclosure, in order to exemplify the broad jurisdictional powers of the bankruptcy court under 77b. Since it has already been demonstrated herein (*Prudential v. Liberdar, supra*), that a receiver in an equity general receivership suit holds for the benefit of all creditors, secured and unsecured, and that the mortgagee may therein obtain the rents and profits by merely applying to the court, it follows automatically under 77b (a), as interpreted by Mr.

* Quoted, Appendix, p. E-12.

Justice Cardozo in the *Duparquet* case, that the same rights exist in a 77b proceeding.

Under the statute, all the debtor's assets are in the hands of the court pending determination whether a reorganization can be effected. If the reorganization is effected, a mortgagee's rights of course are protected by the plan of reorganization. If the reorganization cannot be effected, the proceeding is either dismissed or liquidated. Obviously the mortgagee's hands are more firmly tied under Section 77b than in an ordinary bankruptcy proceeding so far as foreclosure is concerned, and it is conceivable that foreclosure may be deferred for many months by reason of the pendency of abortive reorganization proceedings. Indeed, such was the fact in the present case, where it was not until October 9, 1935 (R. 62), that an order of liquidation was entered, being some sixteen months after the 77b proceedings started. In the present case the debtor owned practically no assets other than the mortgaged properties, and in the nature of things it would have been inconsistent for the court to permit the foreclosure of any of the properties until the proceedings were either dismissed or the estate liquidated. Once the court assented to the proposition that there was no equity for the bankrupt estate in the mortgaged properties, by the same token the court admitted that reorganization was impossible, as there were no other assets. The whole purpose of reorganization plan was to scale down the mortgage debts and interest so that the debtor might remain in

possession of the mortgaged properties (R. 68).

Fairness and equity require, where the mortgagee is stayed from proceeding with his normal remedy of foreclosure, that he at least have the protection in the interim of having the rents and profits applied. The rule laid down by the District Court that the mortgagee is powerless and remediless in the interval is so harsh and extreme as to amount to the taking of property without due process of law, particularly in the state of the property here involved.

We can understand why a 77b court would insist that the rents be retained by the trustee until it is determined whether or not reorganization is feasible, but once it is determined that reorganization is impossible and liquidation is ordered, as in the present case, the general creditors should not benefit at the expense of the mortgagee, whose foreclosure rights have been suspended in the meantime.

All the authorities are in accord with the foregoing reasoning:

Re Tamble, 88 F. (2d) 893 (C.C.A. 7), (construing Sec. 74).
Central Hanover Bank v. Philadelphia R. R. Co., supra, (C.C.A. 3), (Section 77b).
Florida Bank v. U. S., 87 F. (2d) 896 (C.C.A. 5), (Section 77b).
Re Huff, 24 F. Supp. 565 (D.C., N. D. Ala.), (Section 74).

The foregoing cases hold that the mortgagee is entitled to the rents and profits irrespective of the

filing of any petition therefor. This result we believe to be fair and equitable, in view of the difference between 77b proceedings and ordinary bankruptcy proceedings.

TO DEPRIVE MORTGAGEE OF REMEDY WILL VIOLATE FIFTH AMENDMENT

The cases heretofore cited demonstrate that the bankruptcy court, having complete jurisdiction, must give the mortgagee an equitable remedy similar to that which he would have had had bankruptcy not supervened.

Section 67d* of the Bankruptcy Law protects liens given in good faith for valuable consideration and duly recorded (See R. 60). *Petition of Cox*, 15 F. (2d) 764. See *Hiscock v. Bank*, 206 U.S. 28, 51 L. Ed. 945. If the statute be so construed, however, as to hold that pendency of 77b proceedings prevents the mortgagee from obtaining rents and profits, although in the absence of bankruptcy he would have been entitled thereto upon appropriate proceedings, we submit that the statute under such construction would be void under the Fifth Amendment as depriving the mortgagee of property without due process of law:

Louisville Bank v. Radford, 295 U.S. 555, 79 L. Ed. 1593.
Northern Pacific v. Boyd, 228 U.S. 482, 57 L. Ed. 931.

* See Appendix, p. D-11.

Horn v. Ross Island Sand & Gravel Co., 88 F. (2d) 64 (C.C.A. 9).
Security Bank v. Rindge, 85 F. (2d) 557, 561; certiorari denied, 299 U.S. 613, 81 L. Ed. 452.
See, also, *Duparquet v. Evans, supra.*

In the *Radford* case the Frazier-Lemke Act was held invalid because, although in terms it preserved the rights of the mortgagee, in fact his remedy was so interfered with as in effect substantially to injure his rights. It was held under the severely restricted remedies of that Act that there was effected a "substantial impairment of the security" of the mortgagee.

We submit that the same is true in the present case if it be held that the mortgagee's rights are concluded until foreclosure sale and that he is powerless to obtain the rents and profits collected during bankruptcy, even upon liquidation or dismissal of the 77b proceedings.

In *Horn v. Ross Island* this court said:

> "The Supreme Court in Louisville v. Radford held that the bankruptcy power is subject to the Fifth Amendment and that under the bankruptcy power Congress cannot authorize the bankruptcy court to take for the benefit of the debtor rights in specific property acquired by the creditor * * *."

In *Security Bank v. Rindge, supra,* this court said:

> "The right to retain a lien until the debt secured thereby is paid is a substantive property

> right which may not be taken from the creditor consistently with the Fifth and Fourteenth Amendments to the Constitution. Louisville Bank v. Radford, 295 U.S. 555 * * *."

In the *Rindge* case it was contended that it was inequitable for an assignee of a mortgage who had paid forty cents on the dollar therefor to insist upon payment in full, but the court held that the assignee was entitled to prior lien rights regardless of the price paid for the assignment.

The holdings in the *Radford*, *Ross Island* and *Rindge* cases are to be contrasted to the language of the court below, where it was held that the mortgagees should be penalized because they refused to scale down their security. The court below said:

> "If the mortgage creditors were deprived of remedies during this period, it can only be said that the statute is paramount. Besides, the record indicates that these same creditors played a major part in forcing liquidation by refusal to accept compromise so that the result is not inequitable" (R. 132).

The effect of holding that the mortgagees are barred from acquiring the rents and profits upon dismissal or liquidation of 77b proceedings despite application duly made to the bankruptcy court prior thereto, of course would be to club the mortgagees into accepting reorganization plans. The mortgagees would thereby be forced to surrender security rights, knowing that unless they consented to the plan the proceeding would be prolonged and the rents and profits lost to them forever. The court

cannot do indirectly what it cannot do directly. The mortgagees' lien is not to be impaired either directly or indirectly. The Fifth Amendment does not permit any constraint or compulsion upon a mortgagee to surrender security rights under penalty of loss of other security rights, to-wit, the rents and profits.

The injustice of the holding in the present case is magnified when we recall that jurisdiction was taken by the court below on an ex parte order without a hearing (R. 6). Had there been a hearing it is certain that the court would never have taken jurisdiction under 77b because of the hopelessness thereof. It is an admitted fact in this case that the debtor was insolvent throughout; that the mortgages were delinquent as to taxes and interest, most of which ran back to 1929; that the debtor's affairs were in a state of total collapse; that it had virtually no income except from the mortgaged properties; that fire insurance was not maintained or repairs made, other than absolutely necessary; also that the condition of the debtor became worse as the bankruptcy proceedings continued; also that the mortgages were worth less than the mortgage indebtedness (R. 68-9). It is further an admitted fact that these proceedings were instituted by the debtor purely for the purpose of inducing the mortgagees to scale down their mortgage debts and the interest rate thereon, which proposals were at all times unacceptable to the mortgagees (R. 68). It was conceded by the debtor's general counsel that the proceedings were hopeless, whereupon the debtor

employed other counsel in the hope that it might be able to persuade the mortgagees to cut down the balances (R. 68).

If there are any equities under these circumstances in anyone other than the mortgagees, we fail to see it. We contend that unless the mortgagees are protected in the rents and profits from and after the date of institution of the 77b proceedings, there is a violation of due process. We contend that the ordinary bankruptcy rule prevailing in the Seventh Circuit under Section 77b, which has been adopted also in the Third and Fifth Circuits as to 77b cases, should be universally applied to all 77b cases which result in a liquidation or dismissal. This is so because 77b proceedings are of a more restrictive nature so far as the mortgagee's remedies are concerned than an ordinary bankruptcy case, and upon such dismissal or liquidation there is more reason than in an ordinary bankruptcy case to award to the mortgagee the rents and profits for which he may have failed to apply. In the present case, however, it is of little moment whether the court adopts the rule that the rents shall be paid from the date of application or from the date that the 77b proceedings were filed. "Date of application" in our case must be considered as being no later than the date of the first meeting of creditors before the Special Master, when all the appellants herein protested continuance of possession in the debtor, as result of which protest a trustee was named with instructions to segregate income.

APPLICATION OF FOREGOING PRINCIPLES TO THE FACTS OF THE PRESENT CASE.

The foregoing authorities establish the proposition that a mortgagee is entitled to rents from mortgaged premises in the possession of a court of bankruptcy from the time of sequestration or from the time when he asserts his claim to them in the bankruptcy proceeding. Leaving for later consideration the added arguments of Portland Trust and Savings Bank based upon its foreclosure suits commenced prior to bankruptcy, let us first consider the facts as to the claims of all three appellants.

A sequestration was made by the bankruptcy court in this proceeding in August, 1934. When the order of good faith under Section 77b was taken ex parte on July 11, 1934, the entire matter was referred to Roy F. Shields as Special Master to conduct hearings and make his report to the court (R. 6). Notice was given to creditors and hearings were had before the Special Master on August 2nd and August 13th. At these hearings the appellants appeared by counsel and participated as mortgagees holding mortgages on several parcels of real property (R. 6). The mortgagees opposed the plan of reorganization and orally objected to the continuance of the bankrupt in possession during the pendency of the proceeding. They must also have asserted claims to the rents for the Special Master in his report recommended that a trustee be ap-

pointed, and that he be required to keep separate accounts of the rents received and disbursements made as to each of the properties covered by a mortgage "so that the disposition of said funds can ultimately be made in accordance with the determination that the court may hereafter make as to the ownership thereof" (R. 7). The court confirmed the report of the Special Master and required the trustee to keep such separate accounts (R. 7-8). When the trustee who was first appointed failed to qualify and C. W. Twining was appointed on September 10, 1934, an identical provision for segregation was contained in the order of appointment (R. 8). Likewise when an order of liquidation was entered and H. E. Eakin was appointed as liquidating trustee, October 9, 1935, he was also required to keep separate accounts of and to segregate receipts and disbursements as to each of the several properties of the debtors (R. 62 and 63). The various orders of segregation have been complied with by all trustees in the proceeding and from time to time accounts have been filed herein showing the same (R. 71).

We respectfully submit that this was a sufficient sequestration of the rents and profits on behalf of the mortgagees. Under the authorities no particular form of sequestration is required, and it is not necessary for mortgagees to assert their rights in any particular manner. Any method reasonably calculated to bring to the attention of the

trustee or the court in the bankruptcy proceedings the claim of the mortgagee, seems to be sufficient. A letter addressed to the trustee in bankruptcy was held to be sufficient in Mortgage Loan Co. vs. Livingston (8 C.C.A.), 45 Fed. (2d) 28. Here the mortgagees appeared at the first opportunity in the hearing before the Special Master, asserted their rights as mortgagees, and obtained an order that the rents from each of the mortgaged properties be kept separate and apart so that the income could ultimately be disposed of in accordance with the determination of the court as to the ownership thereof. That constituted a setting apart of those funds for the benefit of the mortgagees to be awarded to them upon proper proof that they held valid mortgage liens thereon.

The appellants followed up the original order of sequestration dated August 13, 1934, by filing in the bankruptcy proceeding formal petitions in which they set up their respective mortgages and prayed for leave to foreclose and that the rents be segregated for application upon their mortgage indebtedness. Within approximately a month after possession of the property was taken by the trustee, such petitions were filed on behalf of Investors Syndicate (October 22, 1934) and Metropolitan Life Insurance Company (October 24, 1934).

A similar petition was not filed at that time on behalf of Portland Trust and Savings Bank for the reason that the mortgages of that appellant were

already in process of foreclosure and the rents were being paid over to Kaste by the trustee in bankruptcy for application under the sequestration orders of the state court. After the trustee ceased paying the rents to Kaste, the bank filed a petition on February 5, 1935, for an order requiring both Kaste and the trustee in bankruptcy to pay all rents over to the state court for application on its mortgages, as will be hereinafter more fully shown. Under the authorities cited there can be no question as to the sufficiency of these petitions to entitle the mortgagees to the rents accrued and to accrue in the hands of the trustee in bankruptcy.

PORTLAND TRUST & SAVINGS BANK'S RIGHTS TO RENTS AND PROFITS VESTED BEFORE BANKRUPTCY

We have heretofore stated in some detail the special facts relating to Portland Trust (supra, pp. 4-6). It becomes necessary at this stage to restate the essential facts as a basis for consideration of the added legal features which entitle the bank to recover.

Portland Trust instituted foreclosure proceedings long before bankruptcy. Such state foreclosure suits were accompanied by petitions for appointment of a Receiver. But the state court chose to impound the rents, by requiring the debtor to pay them into court, instead of by the appointment of a Receiver. This was a mere matter of procedural

machinery and did not alter the fact that the state court took jurisdiction of the rents and profits for the benefit of the mortgagee. The order is quoted in the record (R. 9-10). It requires Guaranty Trust Company on the 12th day of each month to file verified account and return in the state court covering the operation of the apartment houses involved in each of the two foreclosure suits during the preceding month, showing all rentals and other income collected and all disbursements made during said accounting period. It further requires Guaranty Trust Company at said times to "pay into court the net income derived from said mortgaged premises during said accounting period, *to be held as a part of the security for said mortgage indebtedness* and to be applied according to the further orders of the Court". This is not a mere direction to pay the money into court subject to future determination as to whose money it is. The order specifically states that the moneys are "to be held as a part of the security for said mortgage indebtedness". We contend that this order was a *receivership* order. *Hitz v. Jenks*, 123 U. S. 97, 31 L. Ed. 156.

Not only was this order complied with in every particular prior to the bankruptcy proceedings, but it was also complied with subsequent to the bankruptcy proceedings and until the time that 77b petition was filed some four or five months after the original involuntary petition (R. 11). Not only did the bankruptcy court permit the rents to be paid into the state court after the filing of the

involuntary petition, but to eliminate any question of doubt in the matter, an order was entered by the District Court under date of April 25, 1934, specifically stating that "the alleged bankrupt shall not be restrained from complying with the order of the Circuit Court of the State of Oregon, entered in the aforesaid foreclosure proceedings, requiring it to pay into Court monthly the net proceeds derived from the operation of the properties described in the foreclosure proceedings" (R. 11-12). This order further permitted the foreclosure proceedings in the state court to continue. The reason for entry of the order was that shortly after the filing of the involuntary petition, to-wit, January 31, 1934, the District Court had entered a general order staying all pending proceedings (R. 11), and it was therefore necessary to enter a special order exempting Portland Trust from the effect of the general order.

In fact, it was not until September 11, 1934, that the Trustee herein began to collect the rentals from these mortgaged properties. From June to September the rentals were collected by Kaste, attorney for the bankrupt, and were held by him pending further order of the Court (R. 12). An order then issued requiring payment by Kaste to the Trustee (R. 13).

Not only did the District Court expressly recognize the prior lien of the bank to the rents and profits by reason of the order of April 25, 1934,

and the other matters above recited, but same was recognized by other affirmative matters occurring in the 77b proceedings. Thus, at the outset of the 77b proceedings and thereafter upon the appointment of each successor Trustee, the Court required that a separate account be kept of each of the mortgaged properties (R. 7-8). (It is to be remembered that the bankrupt owned nothing of any substance except the mortgaged properties.) Furthermore, not only were the moneys collected from the apartments mortgaged to Portland Trust segregated for bookkeeping purposes, both as to receipts and disbursements, but such rentals were deposited in a trust account at The Bank of California, and ever since have been and are now held in that trust account (R. 13). Furthermore, at the hearing before the Special Master on the petitions herein involved, Messrs. Bischoff and Coan, who appeared as appellees and also as attorneys for other appellees herein, referred to the Portland Trust moneys as constituting a trust fund, as did also the attorneys for the bankrupt (R. 14-15).

Under these circumstances we believe there can be no doubt as to the claim of Portland Trust to the rentals impounded in the trust fund at The Bank of California. (The State Court funds have already been applied, but deficiencies remain—see supra, p. 15).

As before stated, all the authorities agree that the bankruptcy court, even in 77b proceedings, takes

the bankrupt's assets subject to prior liens, and therefore that where a mortgagee has sequestered the rents and profits, either by actual possession, possession through a Receiver, or otherwise, the mortgagee's rights are prior.

Duparquet v. Evans, 297 U.S. 216, 222; 80 L. Ed. 591.
Straton v. New, 283 U.S. 318; 75 L. Ed. 1060.
Continental Bank v. 19th & Walnut Corp., 79 F. 284 (C.C.A. 3rd).
Re Shelburne, 91 F. (2d) 190 (C.C.A. 3d).
Federal Reserve v. Weant, 113 Or. 1.

Thus, in *Duparquet v. Evans*, 297 U.S. 216, 222, 80 L. Ed. 591, the court stated:

"* * * It is * * * common learning that not even a trustee in bankruptcy may override a valid mortgage lien or supersede a receiver who has been put into possession in fulfilment of the mortgage contract. Straton v. New, 283 U.S. 318, 322, 327, 75 L. Ed. 1060, 1093, 1098, 51 S. Ct. 465; Metcalf v. Barker, 187 U.S. 165, 47 L. Ed. 122, 23 S. Ct. 67; Lincoln Sav. Bank v. Realty Associates Security Corp. (C.C.A. 2d), 67 F. (2d) 895; Re Berdick (D.C.), 56 F. (2d) 288; Russell v. Edmondson (C.C.A. 5th), 50 F. (2d) 175; Re Brose (C.C.A. 2d), 254 F. 664; Carling v. Seymour Lumber Co. (C.C.A. 5th) 113 F. 483, 491."

That sequestration prior to bankruptcy would bar the Trustee herein, was expressly recognized in the opinion of the court below, citing the case of *American Trust Co. v. England*, 84 F. (2d) 352 (C. C.A. 9), (R. 127-8).

However, it is contended by our opponents that there must have been an actual receivership or actual possession on the part of the mortgagee to bar the bankrupt estate from holding the rents and profits for general creditors. On its face, this is a shocking argument, implying as it does that the form under which the state court takes hold of the rents and profits is determinative of the mortgagee's rights, rather than the substance of what was done by the state court. We believe the following authorities will amply demonstrate that there was a sufficient sequestration prior to the bankruptcy proceedings:

In *Hitz v. Jenks,* 123 U.S. 297; 31 L. Ed. 156, Keyser as receiver of a national bank, sued to enforce a deed by way of mortgage. Mrs. Hitz defended, claiming she was induced to sign with her husband by fraud and also claiming fraudulent alteration. The lower court held for her but that the deeds were valid as against her husband and ordered Keyser to account for rents previously collected and to collect and pay into court all subsequent rents collected. On appeal to the Supreme Court of the District of Columbia this was reversed as to Mrs. Hitz, and Keyser won completely. She then appealed to the United States Supreme Court and claimed among other things that she was entitled to rents paid into court pending the intermediate appeal. She relied, as do appellants in the present case, on *Teal v. Walker,* 111 U.S. 242, 28 L. Ed. 415. Her claim was that the mortgagee

had not been put into possession of the land by her and therefore she was entitled to the rents. The court, however, disposed of this contention as follows:

> "The conclusive answer to this argument is that the accruing rents were not received and held by Keyser by virtue of an agreement with Hitz; but the court, through Keyser as its receiver, took possession of these rents in order to preserve them for the party who should ultimately prevail in the suit. When it was afterwards adjudged that the * * * the second deed of trust was valid as against Mrs. Hitz; and the sum obtained for the land at a sale under the power contained in this deed proved insufficient, by more than the whole of the fund in court, to pay the debt of Hitz to Jenks, secured by this deed, it was rightly held that Mrs. Hitz had no right as against Jenks to any part of this fund."

The appointment of the plaintiff in the case just referred to as the agent of the court to collect the rents and pay them into court as they accrued, is identical with the order which was entered by Judge Lusk in the state foreclosure proceedings here concerned, with the exception that in our case the defendant was required to collect and pay into court, whereas in the Hitz case the plaintiff was so required. In neither case was the appointment designated in the lower court as a "receivership", but just as the United States Supreme Court deemed that in fact the plaintiff was acting as a receiver for the court, so in fact was Guaranty Trust Company acting as receiver for the court in our case.

Nomenclature is immaterial; the fact is that the collections were made pursuant to court order and that the party collecting in either case would have been in contempt if that order had been disobeyed.

In re Berdick, 56 F. (2d) 288 (D.C., S.D. N.Y.), is to similar effect and is especially worthy of notice inasmuch as it was cited with approval by the United States Supreme Court in the *Duparquet* case, as hereinbefore quoted. In the *Berdick* case foreclosure suit was filed, but to dispense with the appointment of receiver the owner notified the tenants to pay the mortgagee direct, whereupon the latter collected the November rentals. On November 27th bankruptcy occurred. The bankruptcy receiver claimed the rents on the ground that no receiver had been appointed in the foreclosure suit, but the court held for the mortgagee, stating:

> "It thus appears that the mortgagee is for all practical purposes in possession of the premises by consent of the mortgagor and is receiving the rents. In the language of the court in Sullivan v. Rosson, supra, the mortgagee has taken possession of the rents and of the right to them 'through some mutual arrangement therefor'. * * * It is quite clear that its rights are superior to those of the receiver in bankruptcy."

The United States Supreme Court held in *Metcalf v. Barker,* 187 U.S. 165, 47 L. Ed. 122, that in a suit to assert an equitable lien (there a creditor's bill), the judgment related back to the date of the filing of the bill, and that since the date in that case was more than four months before bankruptcy,

the state court jurisdiction was prior and the equitable lien was to be considered as vested from the date of the filing of the bill.

Sequestration is not a technical conception; it is not even necessary that an order of court be entered, as was done in the present case. A stipulation between the parties in a foreclosure proceeding has been held sufficient to amount to sequestration: *Farmers Union v. Sullivan*, 137 Kan. 196, 19 P. (2d) 476; *Hall v. Goldsworthy*, 136 Kan. 247, 14 P. (2d) 659. See 41 C. J. 628.

We contend therefore that there was sufficient sequestration in the state court and that the bankruptcy court was powerless to overcome the prior lien rights vested in the bank to the rents and profits. Furthermore, as previously shown, the bankruptcy court expressly recognized the prior vested rights of the bank and permitted the moneys to be paid into the state court for a considerable time after institution of the bankruptcy proceedings and even after that time segregated the funds and placed them in a separate bank account as a trust fund. Collection of the rents and profits by the Trustee herein was in express recognition of the bank's prior rights. All that the bankrupt estate owned beneficially at any stage of these bankruptcy proceedings was the worthless equity of redemption. Except for the debtor's imposition upon the court in the present case, whereby the court was led to believe that there were equities in the various mort-

gaged properties, the court would never have taken jurisdiction under 77b in the first place, and no rentals would ever have been paid into the hands of the Trustee from the apartments mortgaged to the bank.

Such sequestration was expressly recognized and deferred to by the bankruptcy court, which for several months permitted the rents to be paid into the state court (R. 11-12), and which placed all rents from properties mortgaged to Portland Trust in a special trust account at The Bank of California (R. 13).

MORTGAGEES' REMEDY IN BANKRUPTCY COURT NOT IMPAIRED BY STATE LAW

It is contended by appellees that under the law prevailing in the State of Oregon a mortgagee, unless he takes possession prior to bankruptcy or has a receiver appointed prior to bankruptcy, is utterly without remedy thereafter in the bankruptcy court so far as obtaining the rents and profits is concerned. This argument is predicated on the theory that the claim to the rents and profits under the mortgage agreement is nothing more than an inchoate right and that the lien does not vest until possession is taken by the mortgagee directly or through a receiver, which is ordinarily impossible in a court of bankruptcy.

Appellees' argument concerning the Oregon law is based upon a misinterpretation of the case of

Teal v. Walker, 111 U.S. 242. That case merely held as a matter of common law that so long as the mortgagor has possession he need not account for the rents and the court said that this conclusion was "strengthened" by the Oregon statute as it stood prior to the 1927 amendment. It is clear that the court did not consider that the law in Oregon was different from the general common law on the subject, but on the contrary the Oregon statute merely affirmed the common law. The court's opinion shows clearly that in a proper case a receivership could be granted under the Oregon statute even before the 1927 amendment.

Appellees rely also on the cases of *Thomson vs. Shirley,* 69 F. 484 (D. Or.), and *Couper vs. Shirley,* 75 F. 168, (C.C.A. 9). In the former case the court appointed a receiver under a provision in the mortgage so permitting, but no showing was made by the plaintiff as to any equitable reason why the receivership was necessary. The sole question, therefore, was whether the agreement for the receiver was an enforcible contract obligation. The court held otherwise in the absence of a showing requiring the intervention of a court of equity, such as insecurity or waste, both of which are present in our case. However, the court was careful to point out that it did *not* hold that a receiver would not be appointed on a proper showing, stating:

> "The stipulation in the mortgage that upon the mortgagor's default a receiver may be appoint-

> ed to take the crops, in no wise enlarges the rights of the mortgagee. *In a proper case a receiver will be appointed without such stipulation.* In no other case should one be appointed, no matter what the parties may agree beforehand. The only exception to the well-established rule which excludes the mortgagee from possession of rents and profits by a receiver is in that class of cases where the value of the property mortgaged is threatened with loss or destruction."

We believe that the court's statement as to the grounds for appointing a receiver were too narrow, but they were not necessary to the opinion in the case because no grounds at all were shown other than the provision in the mortgage.

On appeal the court in the case of *Couper vs. Shirley* affirmed the lower court's decision but considerably modified the language. The court there said:

> "It must be borne in mind that the appointment of Couper as a receiver was not made by virtue of any of the established general principles of equity, which, when alleged to exist, would authorize a court of equity to appoint a receiver, but was made solely in pursuance of the stipulation contained in the mortgage. The sole question for our consideration is whether such a stipulation, *of itself,* authorized the court to make the appointment, under the laws of Oregon."

And again:

> "It is enough to say that it has been authoritatively settled that, under the provisions of the statutes of Oregon, they have no power to *bind*

> *the courts,* independent of any equitable condition which might be shown to exist, by any stipulation, contract, covenant or agreement contained in the mortgage for the appointment of a trustee or receiver to take charge of the rents, issues and profits of the mortgaged premises pending a foreclosure of the mortgage."

But what application do *Teal v. Walker* and the *Shirley* cases have to our case? The answer is, none whatsoever. This is a bankruptcy case; those were not. In the *Teal* case, as between mortgagor and mortgagee, the latter claimed to be entitled to the rents and profits automatically on default by alleged self-executing provisions of the mortgage. There was no application for sequestration to any forum whatsoever until after the rents and profits had been collected. In the *Shirley* cases, an application was made for appointment of receiver, but no grounds were shown sufficient to justify equitable interposition—the mortgagee relied solely on the clause in the mortgage.

The present is a case where admittedly there was ample ground for the appointment of a receiver, if bankruptcy had not intervened. Waste existed, taxes unpaid for years, the properties permitted to deteriorate, no repairs made, insurance unpaid, income fully applied for the mortgagor's private purposes. The state court had protected Portland Trust by an order tantamount to a receivership (supra, p. 48); the other mortgagees had not asked for receivership prior to bankruptcy be-

ed to take the crops, in no wise enlarges the rights of the mortgagee. *In a proper case a receiver will be appointed without such stipulation.* In no other case should one be appointed, no matter what the parties may agree beforehand. The only exception to the well-established rule which excludes the mortgagee from possession of rents and profits by a receiver is in that class of cases where the value of the property mortgaged is threatened with loss or destruction."

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cause of certain promises that were never fulfilled (R. 42-4). After bankruptcy, timely application is made. The situation thus presented to the bankruptcy court, as contrasted to the situation before the court in the *Teal* case and the *Shirley* case, is that every ground for equitable jurisdiction for appointment of a receiver exists — insecurity of the mortgagee, waste, deterioration and threatened destruction of security value. Under these circumstances, a receiver would clearly have been appointed in the state court. Is the bankruptcy court to be bogged down by the technicality that no application for receiver was made prior to bankruptcy? The answer is contained in the many cases which we have cited from this and other circuits to the effect that the mortgagee will be held entitled in the bankruptcy court upon proper application, or other act of the mortgagee indicating his election. And this is true because now the bankruptcy court is the only forum to which the mortgagee can look. It alone has jurisdiction, and being a court of equity, will apply an equitable remedy that meets the need.

If there were ever any thought that in Oregon under the *Teal* and *Shirley* cases, a mortgagee, in the absence of voluntary surrender of possession by the mortgagor, is not entitled to rents and profits until purchase at sheriff's sale, such misconception is entirely overthrown by the 1927 Amendment to the Oregon statute—Laws 1927, Chap. 310, Sec. 1. Prior to 1927 our statute read:

> "A mortgage of real property shall not be deemed a conveyance so as to enable the owner of the mortgage to recover possession of the real property without a foreclosure and sale according to law."

But in 1927 the following proviso was added:

> "Provided, that nothing in this act contained shall be construed as any limitation upon the right of the owner of real property to mortgage or pledge the rents and profits thereof, nor as prohibiting the mortgagee or pledgee of such rents and profits, or any trustee under a mortgage or trust deed from entering into possession of any real property, other than farm lands or the homestead of the mortgagor or his successor in interest, for the purpose of operating the same and collecting the rents and profits thereof for application in accordance with the provisions of the mortgage or trust deed or other instrument creating the lien, nor as any limitation upon the power of a court of equity to appoint a receiver to take charge of such real property and collect such rents and profits thereof." Or. Code 1930, § 5-112.

Of what importance, then, are the *Shirley* cases, or the *Teal* case, decided before 1927? As we will hereafter show, the 1927 statute did not change this law—it was always true in Oregon that the court through receivership or otherwise would in a proper case apply rents and profits for the benefit of a mortgagee. But because of misconception of the *Teal* and *Shirley* cases, the 1927 Amendment was adopted as an expository statute to make clear the fact that the ordinary common law equitable remedies were available in Oregon and that the provi-

sions of the old statute were never intended to interefere with such common law equitable remedies. (It is again to be noted that the United States Supreme Court in *Teal v. Walker,* held that the old Oregon statute "strengthened" the common law rule that the mortgage is not self-executing as to rents and profits on default — clearly indicating that Oregon is not an exceptional state, but that it conforms to the common law rule. The 1927 Amendment makes it clear that Oregon conforms to the common law rule as to equitable remedies in case of default — application of rents and profits prior to foreclosure sale where equitable grounds exist, as they do in our case.)

Oregon has a general receivership statute reciting the various cases in which receiver may be appointed: Oregon Code 1930, Section 32-702. The statute reads in part as follows:

> "A receiver may be appointed by the court in the following cases:
>
> > "1. Provisionally, before judgment or decree, on the application of either party, when his right to the property, which is the subject of the action, suit or proceeding, and which is in the possession of an adverse party, is probable, and the property or its rents or profits are in danger of being lost or materially injured or impaired; * *"

The above statute in its reference to "rents or profits" that "are in danger of being lost" to the mortgagee constitutes explicit authority on the part of the court for the appointment of receiver in a

mortgage foreclosure suit, being in this respect a duplication of the 1927 Amendment to Oregon Code 1930, Section 5-112.

As illustrative of the common law rule whereby a court of equity will in a proper case appoint a receiver, or otherwise sequester the rents and profits, we quote from *Freedman's Sav. & T. Co. v. Shepherd*, 127 U.S. 261, 32 L. Ed. 163. There it is said:

> "As was said in *Kountze v. Omaha Hotel* Co., 107 U.S. 395, 'courts of equity always have the power where the debtor is insolvent, and the mortgaged property is an insufficient security for the debt, and there is good cause to believe that it will be wasted or deteriorated in the hands of the mortgagor, as by cutting of timber, suffering dilapidation, etc., to take charge of the property, by means of a receiver, and preserve not only the *corpus* but the rents and profits, for the satisfaction of the debt. When justice requires this course to be pursued, and it is resorted to by the mortgagee, it will give him ample protection'."

Neilson vs. Heald, 151 Minn. 181. The court there said:

> "Ordinarily, under our law, the mortgagor or his successor in interest is entitled to the possession of the property and to the rents and profits therefrom during foreclosure proceedings and until the expiration of the period of redemption (Marshall & I. Bank vs. Cady, 76 Minn. 112, 78 N.W. 978); but, if he permits waste of a character to impair the security, and the security is inadequate and those personally liable for the debt are insolvent, a receiver may

> be appointed to take charge of the property and to apply the rents and profits, or so much thereoff as may be necessary for that purpose, in protecting it from preventable waste."

So it is clear under the decisions and statute that ample grounds exist here for sequestration of the rents and profits by a court of equity in Oregon. And our opponents' contention comes down once more to the argument that appellants failed to sequester the rents prior to bankruptcy. This of course is wholly false as to Portland Trust, for whose benefit the rents were sequestered both before and after bankruptcy in the state court. It is true as to Investors Syndicate and Metropolitan Life that no sequestration was made before bankruptcy, but all the appellants herein made timely and repeated requests to the bankruptcy court for the rents and profits, alleging undisputed grounds for application thereof. Under the doctrine of the *England* case, *Livingston* case, *Bindseil* case, *Liberdar* case, and all the other numerous cases heretofore cited, appellants are entitled. There is nothing in the Oregon law, common law or statutory, to the contrary. In this case as in the cases just referred to, the mortgagees appealed to the bankruptcy court for protection as to the rents and profits, and are just as fully entitled thereto.

Oregon has not attempted to protect a mortgagor's rights to rents and profits in the event of bankruptcy. Conversely, Oregon has not attempted by statute or otherwise to deprive the mortgagee

of his equitable remedy, simply because the remedy may not have been asserted prior to bankruptcy. It would be absurd for Oregon, or any other state, to attempt to legislate as to equitable remedies in a court of bankruptcy. It is sufficient that a valid mortgage lien was created under the laws of Oregon which is respected by the Bankruptcy Act (Sec. 67d*); and that in Oregon it is recognized that on default the mortgagee under ordinary equitable principles may have the rents and profits sequestered in a proper case for equitable relief. Upon bankruptcy, state jurisdiction ceases. The bankruptcy power awarded Congress by the Constitution is paramount. The bankruptcy court alone, under the provisions of the Bankruptcy Act, and with the established equity jurisdiction of the bankruptcy court, determines the questions before it.

The bankruptcy court being the only forum, must deal fairly with adverse claimants who intervene by filing petitions asserting adverse claims. The bankruptcy court is the *only* court, and the mortgagee's equitable remedies must be preserved intact, though the relief is necessarily in different form — the bankruptcy court appoints no special receiver for a mortgagee, as the trustee serves for all under the court's direction and control. As stated by this court in *American Trust Co. v. England, supra*, quoting from the *Livingston* case:

"They were, of course, unable to take possession

* See Appendix, p. D-11.

of the property from the receiver, except on an order of court, and the record in this case warrants the conclusion that the receiver was acting not only in behalf of the general creditors, insofar as this property was concerned, but was acting also in behalf of these mortgagees, and he collected and impounded these pledged rents and issues, keeping them separate from his other accounts for apparently no other purpose than to make them available as a part of the security under this second mortgage. * * We are of the view that the mortgagees in effect intervened in the receivership proceedings in aid of their proceedings to foreclose, and this intervention operated to charge all of the net income arising from the operation of the property by the receiver with the lien of their mortgage. * * *

"'To hold that the mortgagees had a legal right to these rents and issues under the provisions of their mortgage, but that they should be precluded from recovering same because they had not technically pursued a legal remedy is to overlook the fact that the property was in the control of a court of equity, and that equitable remedies commensurate with the legal rights of the parties should be available. To take from the mortgagees the property to which confessedly they are entitled under the pledge provision of their mortgage, and transfer it to the unsecured creditors of the bankrupt, appeals to us as harsh, inequitable, and unwarranted.' Mortgage Loan Co. v. Livingston, supra (C.C.A.) 45 F. (2d) 28, 32, 33, 34."

We will not repeat the argument and cases previously cited, that the bankruptcy court will, on appropriate action therein by the mortgagee, award the rents and profits before foreclosure sale. Our present purpose is merely to point out that there is

nothing peculiar to Oregon law to take this case out of the general rule recognized by this and all other circuits that have passed on the question.

Nor can it be stated that Oregon is different because in Oregon the covenant for application of rents upon default is not self-executing. It is true that in Pennsylvania and Illinois and in a very few other states such provision entitles the mortgagee to possession and to the rents and profits upon default, irrespective of application for receiver or sequestration. But of the many cases from the various circuits hereinbefore cited by us for the proposition that on appropiate application the bankruptcy court will sequester rents and profits for the benefit of the mortgagee, practically all of them arose in jurisdictions where, as in Oregon, the provision for rents and profits is not self-executing, but where positive action must be taken by the mortgagee, similar to the situation in Oregon.

Thus, this court in the *St. James* case, 65 F. (2d) at page 84, stated the general rule that the mortgagee was not entitled to the rents and profits until actual possession taken or receiver appointed and stated that such was the rule both in New York and California.

The Now York rule is that a mortgagee is not entitled to possession despite provision to that effect in the mortgage unless he takes actual possession, personally or through a receiver, in a proper case. *Sullivan vs. Rosson,* 223 N.Y. 217, 119 N.E.

405. This again is the same rule as prevails in the State of Oregon, yet the cases are uniform under the New York law that from and after the date of an application in the bankruptcy court by the mortgagee for the rents and profits he will be entitled to same (always assuming that there are equitable grounds for the appointment of a receiver). *In re Brose,* 254 Fed. 664, C.C.A. 2; *Lincoln Bank vs. Realty Associates,* 67 Fed. (2d) 895, C.C.A. 2. These cases demonstrate that under a statutory and common law situation similar to that of Oregon the mortgagee's rights are not cut off on account of bankruptcy.

We have already had occasion herein to point out (supra, pp. 35-6) that in the case of *Prudential v. Liberdar,* 74 F. (2d) 50, which arose in New York, the Second Circuit in holding application by a mortgagee to the equity court in general receivership was sufficient to entitle him to the rents and profits, compared the Oregon Statute (as it existed prior to 1927), as construed in *Teal v. Walker,* to the New York statute. The court held that under both statutes an agreement for the rents and profits upon default was not self-executing but that the remedy was by application to the court, stating with reference to the statute (74 F. (2d) at page 53):

> "It is much more in accord with its spirit that the court should appoint a receiver in foreclosure or if, as in the present case, receivers have already been appointed in a suit for conservation of assets, that the court should retain pos-

session of the property and have the rents collected *for the benefit of all concerned.* In this way the general creditors will not be in position to complain of mismanagement by the mortgagee, while the latter will have its rights protected as fully as though the property were in its own possession and under its management."

Nor can it be said that the mortgagee's rights to the rents and profits are inchoate and cannot be claimed in the bankruptcy court unless "perfected" prior to bankruptcy. We have shown that all the cases permit a mortgagee to recover the rents and profits after bankruptcy and that the only split in the authorities is as to whether such rents belong to the mortgagee automatically or only upon application to the court. Thus, cases involving assignment of future wages, such as *In re West,* 128 F. 205; *Local Loan Co. v. Hunt,* 292 U.S. 234, 78 L. Ed. 1230, or cases involving mortgage on future crops (*Simms v. Jamieson,* 67 F. (2d) 409) are not in point. The reasoning of the courts in the wage cases is that there is nothing in advance of bankruptcy upon which a lien can be asserted, and further that it is against the policy of the Bankruptcy Act to permit the bankrupt's earnings after the date of bankruptcy to be pledged. The future crop cases are to be distinguished on the ground that the crops are not yet in existence as of the time of bankruptcy, and under the Oregon law there is therefore no lien in effect at time of bankruptcy. However, in a mortgage case, assuming that we have

a valid mortgage, duly recorded, as in the present case, there is a valid lien existing prior to bankruptcy. The right to the rents and profits is incidental to the main lien, and it is merely a matter of remedy to apply the rents and profits to the mortgage indebtedness. The rents and profits spring from the very property which comprises the security right.

AMENDMENT OF 1927 IS APPLICABLE TO MORTGAGES PREVIOUSLY EXECUTED.

The contention will doubtless be made here as it was in the court below that the Investors Syndicate is not entitled to the benefit of the 1927 amendment for the reason that its mortgages were executed prior to the time when the amendment was adopted. The right of the Investors Syndicate to the rents and profits is not dependent on the 1927 amendment since it had ample grounds for the appointment of a receiver upon well established equitable grounds, in accord with the principles announced in *Teal vs. Walker* and the *Shirley* cases. Nevertheless a casual consideration of the matter will disclose that the amendment is applicable to the mortgages of Investors Syndicate even though they were executed prior to its adoption. The opinion of the Special Master to that effect (R. 103-4), confirmed by the District Judge (R. 126-127), is sustained both by reason and authority.

All of the mortgages of Investors Syndicate contained appropriate provisions mortgaging the rents and profits as security for the debt and providing that in the event of foreclosure upon default a receiver might be appointed to collect the rents (R. 56-60). As to three of the properties there were separate assignments of rents of like tenor and effect (R. 54).

The argument that the 1927 amendment is not applicable to mortgages previously executed is based upon the erroneous assumption that no statutes of any kind or character may be given a retroactive application. It also overlooks the well established distinction between statutes dealing with substantive law and those relating to the remedy. We propose to show by two distinct lines of authority that the Investors Syndicate is entitled to the benefit of the 1927 amendment.

(1) In the first place, the 1927 amendment should be given a retroactive application for the reason that it is a declaratory or expository type of statutory enactment designed to clarify the meaning of the original statute. As such, it will be construed to have determined the meaning of the original statute from the time of its enactment, subject only to the constitutional restriction that such application may not be made if the effect would be to impair any vested rights or interests.

That the 1927 amendment is a declaratory or expository statute there can be no doubt. In fact it

would be difficult to find a better illustration of that kind of enactment. That it was not intended to create new, substantive rights or liabilities is shown both by its form and substance. The amendment is in the form of a proviso which is generally not used to create new rights or liabilities but rather to explain or qualify what has gone before.

> *Minis vs. United States,* 15 Pet. 423.
> *Meyers vs. Pacific States Lumber Co.,* 122 Ore. 315, 259 Pac. 203.
> *Olson vs. Heisen,* 90 Ore. 176, 175 Pac. 859.

The amendment merely declares how the existing statute "shall be construed". It begins with the significant language that "nothing herein contained *shall be construed* as any limitation upon the right of the owner of real property to mortgage or pledge the rents or profits thereof * * *."

It seems to be well established that a statute or amendment declaring the meaning of an existing statute, which can be so applied without the disturbance of intervening vested rights will be held to determine the proper construction of the statute from the beginning.

59 C. J. 1181:

> "An expository or declaratory act is one that does not purport to change the former law, but only to determine the proper construction to be placed upon the common law or a former statute.
>
> As a general rule, an act declaring the proper construction of a former statute is giving a retroactive operation so as to determine the meaning of the earlier statute from its enactment."

Washington Railway Co. vs. Martin, 7 D.C. 120:

"Now, although it is not within the competency of even the legislative power to deprive any person of a vested right, by means of a declaratory act, yet when no right has been already secured under the former act, the legislature may declare its meaning by a subsequent law, and this will be held to be the meaning of the first law from the beginning, for no wrong is thereby inflicted, since no rights had become vested."

Clayton vs. Schultz, 50 Pac. (2d) 446 at 449, 4 Cal. (2d) 425.

"While a declaratory statute cannot bind the courts with respect to application of the original statute to transactions which occurred or rights of action which accrued prior to passage of the declaratory act, yet in the absence of intervening rights, an act declaratory of a former one has the same effect as if embodied in the original act at the time of its passage."

To the same effect:

Mosle vs. Bidwell, 130 Fed. 334 (2 C.C.A.).
Cowell vs. Colorado Springs, 3 Colo. 82.

There is no good reason why these principles should not be applied to the 1927 amendment of Section 5-112 Ore. Code 1930. The right of the legislature under the constitution of Oregon to enact retrospective or retroactive statutes has long been recognized. MacKenzie vs. Douglas County, 91 Ore. 375, 178 Pac. 350. Curative and remedial statutes of various types have frequently been enacted in

Oregon and given a retroactive application. *Menasha Co. vs. Coos County,* 66 Ore. 431, 134 P. 1037.

Although the 1927 amendment has never been construed by the Supreme Court of Oregon, it has been applied to previously executed mortgages by many Circuit Courts. Also, it has been decided in the Federal District Court of Oregon that the amendment is a declaratory statute and applies to mortgages previously executed. *New York Life Insurance Co. vs. Progressive Realty Co.,* decided January 7, 1935 (unreported) (R. 127).

It cannot be successfully asserted that the application of the 1927 amendment to the previously executed mortgages of the Investors Syndicate disturbs any vested rights or impairs the obligation of any contract. On the contrary the 1927 amendment operates in favor of the enforcement of contract obligations made by the parties. Section 5-112 Ore. Code 1930 prior to the amendment, under the doctrine of *Teal vs. Walker* and the *Shirley* cases, rendered the contract provisions for obtaining the rents and profits unenforceable as being against the declared public policy of the state.

As stated in *Teal vs. Walker,* such provisions were "not expressly prohibited by law". They were neither malum prohibitum or malum in se. But they remained dormant as long as the previous construction of the statute constituted an impediment to their enforcement.

It seems obvious, without an examination of

authorities, that a change in the law whereby a contract is rendered enforceable in accordance with its terms could not be considered an "impairment" of the contract. It seems equally obvious that a mortgagor who has entered into a contract providing for the remedy of a receiver to collect rents and profits does not have a vested right in the impediment to the enforcement of that contract, and should not be heard to complain of a subsequent change in the law which has the effect of making the contract enforceable according to the intention of the parties. The principle is stated in 12 Corpus Juris 1060:

> "A statute may not be declared unconstitutional on the ground that it gives binding force to a voluntary agreement void or unenforcible when made. Acts validating usurious loans and those perfecting defective conveyances may be mentioned as examples of this class of legislation."

12 C. J. 1064:

> "It is within the power of the legislature to give validity to contracts previously made by a corporation which are unenforcible by reason of the corporation's having been defectively organized or organized under an invalid statute, or, in the case of a foreign corporation, invalid because of its failure to comply with a condition precedent to its right to do business in the state."

The text is amply supported by cases holding that no constitutional rights are invaded where a contract unenforceable when made is rendered enforceable by a subsequent change in the law.

Gross vs. U. S. Mortgage Co., 108 U.S. 477, a leading case, holds that a mortgage unenforceable when made because it was against public policy, may be rendered enforceable by a subsequent change in the law without depriving defendant of any vested rights, since a party cannot have a vested right in an impediment to the enforcement of a contract.

To the same effect:

National Surety Co. vs. Architectural Co., 226 U.S. 276.
Ewall vs. Daggs, 108 U.S. 143.
Watson vs. Mercer, 8 Pet. (U.S.) 88.
Prideau vs. Des Moines Joint Stock Land Bank, 34 Fed. (2d) 308.
Bennington County Savings Bank vs. Lowry, 160 Wis. 659, 152 N.W. 463.

(2) By a different line of reason and authority the conclusion may also be reached that the 1927 amendment is applicable to the provision in the Investors Syndicate mortgages for the appointment of a receiver upon foreclosure. All of the mortgages of Investors Syndicate not only mortgage and pledge the rents and profits as a part of the security for the debt, but they also provide that in the event of default and upon foreclosure the Court shall appoint a receiver to collect the rents and profits.

Receivership is a matter of remedy. It is a remedy employed by a court of equity as an aid in the administration of justice. Since it is not the subject of a separate proceeding but can only be used as an instrument to aid the court in a suit based

on other equitable grounds, it is classed as an ancillary remedy. The provisions in the mortgages of Investors Syndicate to the effect that upon foreclosure a receiver should be appointed to collect the rents and profits amount to contracts for a remedy. At the time these contracts were made they were not enforceable obligations because they were against the public policy declared by Section 5-112 as construed by Teal vs. Walker.

One provision of the amendment is that the statute shall not be construed "as any limitation upon the power of a court of equity to appoint a receiver to take charge of such real property and collect such rents and profits thereof". This part of the proviso had the effect of removing the restriction, if any, contained in the main statute upon the right of the court to appoint a receiver in a foreclosure suit. Since that provision relates to the remedy to be employed in a suit it will be given a retroactive effect, or more properly stated it will be applied by the court to suits thereafter filed even though the cause of suit arose prior to the amendment.

That principle of law is so universally recognized that an extensive consideration of authorities is not required. The rule is well stated in 59 C.J. 1173:

> "The general rule that statutes will be construed to be prospective only and not retrospective or retroactive ordinarily does not apply to statutes affecting remedy or procedure, or, as is otherwise stated, such general rule is subject

to an exception in the case of a statute relating to remedies or procedure. While it has been said that statutes relating to remedies or procedure may be given a retroactive operation, a more accurate statement of the principle intended is that, unless expressly prohibited by statute, and in the absence of directions to the contrary, or unless in doing so some contract obligation is violated or some vested right divested, statutes merely affecting the remedy or law of procedure apply to actions thereafter, whether the right of action accrued before or after the change in the law."

Link vs. Receivers, 73 Fed. (2d) 149:

"It is true that statutes relating to practice and procedure generally apply to pending actions and those subsequently instituted, although the cause of action may have arisen before."

Pacific Indemnity Co. vs. Insurance Co., 25 Fed. (2d) 930, (9 C.C.A. 1928):

In that case this Court held that a California statute passed in 1927 providing that when it appeared in any action that the parties had agreed to resort to arbitration the court should stay the proceedings until the arbitration was completed, was applicable to a contract previously executed for the reason that it was a matter relating to the remedy.

Brainard vs. Coeur d'Alene Mining Co., 35 Idaho 742, 208 Pac. 855:

"Legislation which affects only the remedy or the procedure embraces pending actions, unless it contains words of exclusion." (Citing many cases.)

Other illustrative cases are:

Judkins vs. Jaffee, 21 Or. 89, 27 Pac. 221.
Darling vs. Miles, 57 Or. 593, 112 Pac. 1084.
McGuire vs. Cunningham, 222 Pac. 838, 64 Cal. App. 536.

The foregoing principles and authorities would seem to leave no room for doubt but that the mortgages of Investors Syndicate, although executed prior to the 1927 amendment, are entitled to the benefits of that statute. The same result is obtained whether the statute is viewed as a declaratory enactment which establishes the true interpretation of the statute from the beginning, or whether it is viewed as a statute relating to the remedy. Under either theory to accord Investors Syndicate the benefits of the amendment would not disturb any vested right or impair the obligation of any contract. On the contrary it would serve to give effect to the contract which the parties made. Such a result would be just, as well as lawful.

CONCLUSION

For the reasons assigned, it is contended that the order below should be reversed and decree entered in favor of the mortgagees for the rents and profits to the extent of their deficiencies.

Respectfully submitted,

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APPENDICES

2. That the court erred in holding that all rentals collected by the Trustee in the above proceeding from the Nordell Apartment, Resthaven Apartment, Chapman Court Apartment, Duplex Apartment (First) and Duplex Apartment (Second), upon which the appellant, Investors Syndicate, held mortgages and which were collected prior to sale upon foreclosure of the property covered by said mortgages respectively, should be held and disbursed by said Trustee as a part of the funds available for the payment of expenses of administration and claims of the estate.

3. That the Court erred in sustaining the exceptions of the petitioning and intervening creditors and of Ralph A. Coan and S. J. Bischoff to Conclusions of Law numbered six and seven of the Special Master's Report dated November 14, 1936, wherein the Master found and recommended that the net rentals and income from the Adele Manor and the Charmaine Apartment, in the hands of the Trustee, after making deductions therefrom of amounts representing (a) reasonable furniture rental, and (b) property management charge, should be held by the Trustee for the benefit of the Portland Trust and Savings Bank to be applied toward the payment of its respective mortgages on said respective apartment properties, but limiting recovery in the event of foreclosure sale to the amount of deficiency after said sale.

4. That the Court erred in holding that all ren-

tals collected by the Trustee in the above proceeding from the Adele Manor and the Charmaine Apartment, upon which the appellant Portland Trust and Savings Bank held mortgages and which were collected prior to sale upon foreclosure of the property covered by said mortgages respectively, should be held and disbursed by said Trustee as a part of the funds available for the payment of expenses of administration and claims of the estate.

5. That the Court erred in sustaining the exceptions of the petitioning and intervening creditors and of Ralph A. Coan and S. J. Bischoff to Conclusion of Law numbered eight of the Special Master's Report dated November 14, 1936, wherein the Master found that the net rentals and income from the Maravilla Court Apartment, in the hands of the Trustee, after making deductions therefrom of amounts representing (a) reasonable furniture rental, and (b) property management charge, should be held by the Trustee for the benefit of the Metropolitan Life Insurance Company to be applied toward the payment of its mortgage on said apartment property, but limiting recovery in the event of foreclosure sale to the amount of deficiency after said sale.

6. That the Court erred in holding that all rentals collected by the Trustee in the above proceeding from the Maravilla Court Apartment, upon which the Appellant, Metropolitan Life Insurance Company, held a mortgage and which was collected

prior to sale upon foreclosure of the property covered by said mortgage, should be held and disbursed by said Trustee as a part of the funds available for the payment of expenses of administration and claims of the estate.

Wherefore, the appellants jointly and severally pray that the aforesaid order of the District Court of the United States for the District of Oregon, entered June 8, 1938, be reversed, and that a decree be entered, sustaining and confirming the Conclusions of Law numbered one to eight, inclusive, and No. 10 of the Special Master's Report dated November 14th, 1936.

APPENDIX B

SUMMARY OF ARGUMENT

All mortgages herein concerned contained appropriate provisions mortgaging and assigning the rents on default and for appointment of a Receiver upon foreclosure (R. 26, 35, 54, 55, 59, 60). All the mortgages were in default upon bankruptcy (supra, p. . .) ; the values of the respective mortgaged properties were less than the amount due on the mortgages (R. 69). All the properties had been neglected and waste permitted (R. 69) ; taxes were unpaid since 1929 (R. 68). Therefore, under the state law all the mortgagees would, in the absence of bankruptcy, have been clearly entitled to obtain the rents by appointment of a Receiver or other appropriate means upon appropriate application (See R. 60).

Portland Trust had instituted foreclosure proceedings prior to bankruptcy and applied for appointment of a Receiver (R. 8-9). The state court more than four months prior to bankruptcy, in lieu of appointment of a Receiver, compelled the debtor to pay the rentals into court monthly "to be held as part of the security for said mortgage indebtedness and to be applied according to the further orders of the Court" (R. 10). This was equivalent to a receivership prior to bankruptcy. The order was faithfully complied with, even after the filing of involuntary petition in bankruptcy (January

29, 1934) and continued until petition for 77b proceedings in June, 1934 (R. 11). The District Court on April 25, 1934, in the bankruptcy proceedings, modified the previous restraining order issued by the Court and expressly permitted the bank to pay monthly into the Circuit Court the net rentals from the mortgaged properties (R. 11-12). Even after 77b the Trustee did not collect the rentals directly until September 11, 1934. Kaste then turned over to the Trustee the rents in his hands which he had collected in the interim (R. 13). All moneys collected by the Trustee from the apartments mortgaged to Portland Trust have at all times been held in a separate trust account at The Bank of California (R. 13). Formal petition for the rents was filed by the bank February 5, 1935 (R. 16). These facts amount to sequestration, both before and during bankruptcy, in behalf of Portland Trust.

To protect the various mortgagees, and at their request, the Court in taking jurisdiction under 77b required the Trustee to segregate all revenues and expenses from each of the mortgaged properties (R. 7-8). This in itself was a sufficient sequestration entitling the mortgagees to rents accruing thereafter.

Shortly after the Trustee commenced to collect the rentals from the properties mortgaged to Investors Syndicate and Metropolitan, those appellants intervened by filing petitions for leave to foreclose, and for the rents and profits (R. 28-35).

Such petitions were sufficient to entitle the appellants to the rents and profits.

A mortgagee is not to be denied his ordinary remedy to have the rents sequestered, merely because of the intervention of bankruptcy. The Trustee in bankruptcy holds for all creditors, including mortgage creditors, and upon appropriate application the mortgagee's rights to the rents will be safeguarded. Since receivership in a court other than the bankruptcy court is impossible, when the bankruptcy court has once acquired jurisdiction, the bankruptcy court supplies an equitable remedy appropriate to the bankruptcy procedure, to-wit, transfer of rents and profits to the mortgagee from the date of the latter's application therefor. No such application of course is necessary for Portland Trust, because the rents and profits were impounded for the bank's benefit *before* bankruptcy (but such application was made—R. 16).

Jurisdiction herein under 77b was taken by ex parte order, with no opportunity afforded appellants to be heard in advance. Yet the bankrupt was insolvent at the time (R. 62, 68) and thereafter, and had no assets other than the mortgaged properties (R. 96, 68), nor income other than therefrom (R. 69), and had "milked" the mortgaged properties for years (R. 69). Reorganization was impossible since the security was worth considerably less than the mortgage debts (R. 69, 66-7), and the mortgagees refused to scale down their obligations and

permit this improvident mortgagor to continue as owner (R. 68). The debtor admitted that it "stalled" the proceedings (R. 68). Eventually an order of liquidation was entered (R. 62).

A mortgage creditor's rights cannot be indefinitely postponed and injured by the pendency of 77b proceedings, particularly proceedings such as those herein described. The debtor had no equity and the Trustee should not be permitted, for general creditors or for expenses of administration, to hold rents and profits collected by the Trustee under 77b, which are needed to pay mortgage deficiencies.

The court under 77b is vested with all powers of a court of general receivership: Bankruptcy Act, Sec. 77b (a). As such the Trustee represents secured and unsecured creditors. Since under ordinary bankruptcy the mortgagees are entitled to the rents upon application, *a fortiori* is this true in 77b where creditors' remedies are suspended pending reorganization, dismissal or liquidation (here without a hearing). It has therefore been held in 77b cases that it is not even necessary for a mortgagee to petition for the rents; he will, upon dismissal or liquidation, be protected thereto even without such application.

The Oregon rule on real property requires no different result. The Oregon statute recognizes the mortgagee's right to the rents and profits after possession is voluntarily surrendered or after a re-

ceiver is appointed. This is the usual rule throughout this circuit and elsewhere (only a few jurisdictions grant rents and profits to the mortgagee automatically on default). The Oregon statute contains no specific provision for application of rents and profits in the event of bankruptcy, because obviously that is beyond the jurisdiction of the state court. The bankruptcy court takes title complete in the absence of previous foreclosure instituted, and must apply its own equitable rules. This is a matter of remedy to which the mortgagee is entitled.

But if the bankruptcy court denied the mortgagee a remedy in that court to obtain the rents and profits, this would so seriously impair the mortgagee's security rights as to amount to deprivation of property without due process of law and therefore be void under the Fifth Amendment. Accordingly, it is universally held, whether or not under 77b, that the bankruptcy court will award the rents and profits to the mortgagee. The only dispute (not material in the present case) between the various Circuit Courts is whether the mortgagee is entitled to the rents automatically upon bankruptcy, or must file application for the rents and profits in the bankruptcy court.

APPENDIX C

SECTION 77B(a) OF THE BANKRUPTCY ACT*

"* * * If the petition or answer is so approved, an order of adjudication in bankruptcy shall not be entered and the court in which such order approving the petition or answer is entered shall, during the pendency of the proceedings under this section, have exclusive jurisdiction of the debtor and its property wherever located for the purposes of this section, and shall have and may exercise all the powers, not inconsistent with this section, which a Federal court would have had it appointed a receiver in equity of the property of the debtor by reason of its inability to pay its debts as they mature. * *"

* Only so much of Subdivision (a) is quoted as is pertinent to the matters herein.

APPENDIX D

SECTION 67(d) OF THE BANKRUPTCY ACT*

"Liens given or accepted in good faith and not in contemplation of or in fraud upon the provisions of this title, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall, to the extent of such present consideration only, not be affected by anything herein."

* The applicable statute is quoted prior to the 1938 Amendment.

APPENDIX E

SECTION 77B(c)(10) OF THE BANKRUPTCY ACT

"(c) Upon approving the petition or answer or at any time thereafter, the judge, in addition to the jurisdiction and powers elsewhere in this section conferred upon him, * * * (10) in addition to the provisions of section 29 of this title for the staying of pending suits against the debtor, may enjoin or stay the commencement or continuation of suits against the debtor until after final decree; and may, upon notice and for cause shown, enjoin or stay the commencement or continuance of any judicial proceeding to enforce any lien upon the estate until after final decree."